UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 49 | Number 3 Article 4

4-1-1971

Notes

North Carolina Law Review

NOTES

Civil Procedure—Ancillary Jurisdiction—The Third-Party Defendant's Claim Under Federal Rule 14(a)

"[A]ncillary jurisdiction—the child of necessity and sire of confusion"[1] will now support an impleaded third-party defendant's claim against the original plaintiff without requiring an independent jurisdictional basis. In *Revere Copper & Brass, Inc. v. Aetna Casualty & Surety Co.*,[2] the original defendant, surety on a performance contract, impleaded the contractor under Federal Rule 14(a).[3] The contractor in turn asserted a 14(a) claim against the plaintiff, alleging that plaintiff was responsible for the contractor's failure to complete construction on time. Since both the third-party defendant and original plaintiff were Maryland corporations, the plaintiff moved to dismiss the impleaded party's claim for lack of diversity of citizenship. The motion to dismiss was denied on the ground that the third party's claim was considered ancillary to the plaintiff's original claim. The ruling on the motion was certified for immediate appeal,[4] and the Court of Appeals for the Fifth Circuit, the first appellate court to review the jurisdictional requirements for the impleaded third party's claim, held that no independent jurisdictional basis was required.[5]

Federal courts may resolve those claims over which they have no subject-matter jurisdiction by invoking the concept of ancillary jurisdiction. The theory is that "a district court acquires jurisdiction of a case

---

[1] Note, *Federal Practice: Jurisdiction of Third-Party Claims*, 11 OKLA. L. REV. 326, 329 (1958).

[2] 426 F.2d 709 (5th Cir. 1970).

[3] FED. R. CIV. P. 14(a) in pertinent part states:

> At any time after commencement of the action a defending party, as a third-party plaintiff, may cause a summons and complaint to be served upon a person not a party to the action who is or may be liable to him for all or part of the plaintiff's claim against him. . . . The person served with the summons and third-party complaint, hereinafter called the third-party defendant . . . may . . . assert any claim against the plaintiff arising out of the transaction or occurrence that is the subject matter of the plaintiff's claim against the third-party plaintiff. The plaintiff may assert any claim against the third-party defendant arising out of the transaction or occurrence that is the subject matter of the plaintiff's claim against the third-party plaintiff, and the third-party defendant thereupon shall assert his defenses. . . .

[4] 28 U.S.C. § 1292(b) (1964).

[5] 426 F.2d at 717.

or controversy as an entirety."[6] In the settlement of the principal controversy, claims may arise, which if sued upon alone, could not be presented in the federal court for failure to meet the subject-matter jurisdictional requirements. However, because the district court has jurisdiction over the principal claim, it may resolve those incidental matters that are part of the entire controversy.[7]

Initially the ancillary concept developed in response to necessity.[8] However, necessity could hardly justify the doctrine as it exists today, and the potential importance of the ancillary concept was not fully realized until the adoption of the Federal Rules of Civil Procedure with their liberal joinder provisions.[9] As the federal rules were applied, it became obvious that the purpose of the liberal joinder provisions would be partially defeated if the courts would not give an expansive interpretation to the ancillary jurisdiction concept.[10] In fact, the purposes behind the joinder provisions and the ancillary doctrine are indeed similar. Of prime consideration are the factors of avoiding untimely delays in the settlement of controversies, keeping the expense of litigation to a minimum, and increasing convenience to parties and witnesses to the dispute. Then too the avoiding of piecemeal litigation and the precluding of incongruous results on basically the same factual situations are desired objectives. On the other hand, Congress has clearly defined the jurisdiction of the federal courts,[11] and the purpose of the federal rules is certainly not to extend this jurisdiction.[12] Undoubtedly, every time the ancillary doctrine is applied, these congressional grants of authority are violated.

But is procedural convenience sufficient justification for the avoidance of these grants of jurisdiction?[13] Apparently so, for the majority of courts have held that the doctrine will support the compulsory counterclaim,[14]

[6] C. WRIGHT, LAW OF FEDERAL COURTS § 9, at 19 (2d ed. 1970) [hereinafter cited as WRIGHT].

[7] *Id.*

[8] For example, if property was in the custody of the federal court, any person having an interest in that property could assert his claim in that court without meeting any jurisdictional requirements. To hold otherwise would have been to deny those persons any forum, for the state court had no jurisdiction over property within the custody of the federal system. Freeman v. Howe, 65 U.S. (24 How.) 450, 460 (1860).

[9] *E.g.*, FED. R. CIV. P. 18, 20.

[10] WRIGHT § 76, at 336.

[11] *E.g.*, 28 U.S.C. §§ 1331, 1332 (1964).

[12] FED. R. CIV. P. 82.

[13] *See* WRIGHT § 9, at 20.

[14] *E.g.*, United Artists Corp. v. Masterpiece Prod., Inc., 221 F.2d 213, 216 (2d Cir. 1955); Mayer v. Chase Nat'l Bank, 165 F. Supp. 287, 291 (S.D.N.Y. 1958).

the compulsory cross claim,[15] the interpleader action,[16] and the intervention as of right.[17] On the other hand, ancillary jurisdiction will not support the permissive counterclaim,[18] the permissive joinder of claims[19] unless they are considered pendent,[20] or permissive intervention.[21] From this empirical cross-section, it would appear that ancillary jurisdiction is expanding to support any permissive claim so long as that claim is not asserted by the original plaintiff in the action, and so long as the claim arises from the same transaction or occurrence that is the subject matter of the original claim.[22]

If the concept of ancillary jurisdiction is expanding to support any permissive claim arising out of the same transaction, it certainly has its place under the third-party practice of rule 14(a). The concept was first applied when the federal courts unanimously held that ancillary jurisdiction would support the claim asserted against the impleaded third-party.[23] The theory used to justify this result is that "claim" as used by the federal rules is broader in scope than the older legal phrase "cause of action"

[15] *E.g.*, Coastal Air Lines, Inc. v. Dockery, 180 F.2d 874, 877 (8th Cir. 1950); Hoosier Cas. Co. v. Fox, 102 F. Supp. 214, 228-29 (N.D. Iowa 1952).

[16] State Farm Fire & Cas. Co. v. Tashire, 386 U.S. 523, 530-31 (1967); Haynes v. Felder, 239 F.2d 868, 872-74 (5th Cir. 1957).

[17] *E.g.*, Black v. Texas Emp. Ins. Ass'n, 326 F.2d 603, 604 (10th Cir. 1964); Fomulabs, Inc. v. Hartley Pen Co., 318 F.2d 485, 492 (9th Cir.), *cert. denied*, 375 U.S. 945 (1963).

[18] Measurements Corp. v. Ferris Inst. Corp., 159 F.2d 590, 594 (3d Cir. 1947); Hoosier Cas. Co. v. Fox, 102 F. Supp. 214, 226 (N.D. Iowa 1952).

[19] *E.g.*, Delman v. Federal Prod. Corp., 251 F.2d 123, 126 (1st Cir. 1958); Weintraub v. Fitzgerald Bros. Brewing Co., 40 F. Supp. 473, 475 (S.D.N.Y. 1941).

[20] UMW v. Gibbs, 383 U.S. 715, 725-27 (1966); Hurn v. Oursler, 289 U.S. 238, 246 (1933).

[21] *E.g.*, Hunt Tool Co. v. Moore, 212 F.2d 685, 688 (5th Cir. 1954); Olivieri v. Adams, 280 F. Supp. 428, 433 (E.D. Pa. 1968).

[22] That the claim must arise from the same transaction or occurrence has caused considerable trouble. Initially claims were considered as coming from the same transaction if they bore some *logical relationship* to one another. *Moore v. New York Cotton Exch.*, 270 U.S. 593, 610 (1926). This relationship was said to exist if "separate trials on each [claim] . . . would involve a substantial duplication of effort and time by the parties and the courts." *Great Lakes Rubber Corp. v. Herbert Cooper Co.*, 286 F.2d 631, 634 (3d Cir. 1961). The court in *Revere* redefined this *logical relationship* by requiring either that the same set of operative facts be the basis for both claims, or that the facts giving rise to the original claim activate certain rights in the defendant that would have remained dormant. This redefinition was certainly gratuitous for the claim being asserted in *Revere* would have met even the initial test as one arising out of the same transaction. However, this new definition might be of some importance in considering the application of ancillary jurisdiction to future claims.

[23] *E.g.*, Stemler v. Burke, 344 F.2d 393, 395-96 (6th Cir. 1965); Huggins v. Graves, 337 F.2d 486, 488 (6th Cir. 1964). *See* WRIGHT § 76, at 336.

and means the aggregate of operative facts giving rise to a right enforceable in a court.[24] This claim gives rise to rights in the plaintiff against the defendant and to rights in the defendant against third parties to the action.[25] The defendant's rights, therefore, against third parties are merely a part of the aggregate of operative facts and thus should be considered ancillary.[26]

Once this third-party is impleaded, the original plaintiff may assert any claim against him that arises "out of the transaction or occurrence that is the subject matter of the plaintiff's [original] claim."[27] But here the courts have required an independent basis for federal jurisdiction[28] reasoning that plaintiff could be manufacturing jurisdiction through this third-party practice and through collusive joinder of parties could circumvent "the diversity rule by use of a friendly original defendant."[29]

This third-party also has a right under rule 14(a) to "assert any claim against the plaintiff arising out of the transaction or occurrence that is the subject matter of the plaintiff's [original] claim . . . ."[30] The jurisdictional requirement for this particular claim was the problem before the court in *Revere*. A conflict had developed at the district court level with at least two cases supporting Professor Moore's proposition that an independent jurisdictional ground to support the impleaded party's claim against the plaintiff was required.[31] The language of rule 14(a) giving

[24] Original Ballet Russe v. Ballet Theatre, Inc., 133 F.2d 187, 189 (2d Cir. 1943); 1A W. BARRON & A. HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE § 424, at 653 (1960) [hereinafter cited as BARRON & HOLTZOFF].

[25] *Id.*

[26] Dery v. Wyer, 265 F.2d 804, 807 (2d Cir. 1959), in which the court stated:

> The great weight of authority amongst the federal district courts is to the effect that when federal jurisdiction over the subject-matter of the main action once attaches the court has ancillary jurisdiction to decide a third-party dispute growing out of the same core of facts and hence within the scope of the Rule even though the dispute, separately considered, is lacking in the attributes of federal jurisdiction.

[27] FED. R. CIV. P. 14(a).

[28] *E.g.*, Friend v. Middle Atl. Transp. Co., 153 F.2d 778, 779 (2d Cir.), *cert. denied*, 328 U.S. 865 (1946); Corbi v. United States, 298 F. Supp. 521, 522 (W.D. Pa. 1969); WRIGHT § 76, at 337.

[29] Hoskie v. Prudential Ins. Co. of America, 39 F. Supp. 305, 306 (E.D.N.Y. 1941); 3 J. MOORE, FEDERAL PRACTICE ¶ 14.27[1] (2d ed. 1968) [hereinafter cited as MOORE].

[30] FED. R. CIV. P. 14(a).

[31] *Compare* James King & Son, Inc. v. Indemnity Ins. Co. of N. America, 178 F. Supp. 146 (S.D.N.Y. 1959) *and* Shverha v. Maryland Cas. Co., 110 F. Supp. 173 (E.D. Pa. 1953) *with* Union Bank & Trust Co. v. St. Paul Fire & Marine Ins. Co., 38 F.R.D. 486 (D. Neb. 1965) *and* Heintz & Co. v. Provident Tradesmens Bank & Trust Co., 30 F.R.D. 171 (E.D. Pa. 1962).

rise to the third-party defendant's claim is substantially identical to that describing plaintiff's assertion of a claim against the impleaded party,[32] and Professor Moore reasons that because an independent jurisdictional ground to support the plaintiff's claim is required, so too should there be a requirement of this same independent jurisdictional basis to support the impleaded party's claim against the plaintiff.[33] In conjunction with Professor Moore's argument is rule 82 of the Federal Rules of Civil Procedure which states that "[t]hese rules shall not be construed to extend or limit the jurisdiction of the United States district courts . . . ."[34]

Such an interpretation, however, tends to be rather restrictive in light of the policy behind the federal rules of settling as much in a single controversy as is possible. As could be expected, therefore, a line of cases began to develop at the district court level that did not require this independent jurisdictional ground for the third-party claim against original plaintiffs.[35] These district courts chose to disregard the language upon which Professor Moore relies. Rather the courts focused attention on the reasons supporting different jurisdictional requirements for these apparently identical claims.

To effectuate the purpose of rule 14(a), it would appear that a reason must exist for not allowing ancillary jurisdiction to support the claim. Regarding the original plaintiff's claim against the impleaded third-party this reason is apparent; there exists the possible threat that a plaintiff could manufacture jurisdiction through the use of a friendly defendant.[36] If no independent jurisdictional ground were required for plaintiff's assertion of a claim against the third-party, circumvention of jurisdictional requirements through abuse of rule 14(a) would be the result, and the plaintiff would be able to invoke jurisdiction indirectly when he could not have done so directly.[37] On the other hand this same threat of collusion does not exist in the claim asserted by the impleaded

[32] See text accompanying notes 27 & 30 *supra*.

[33] 3 MOORE ¶¶ 14.27[2].

[34] FED. R. CIV. P. 82. *See* James King & Son, Inc. v. Indemnity Ins. Co. of N. America, 178 F. Supp. 146, 148 (S.D.N.Y. 1959).

[35] Union Bank & Trust Co. v. St. Paul Fire & Marine Ins. Co., 38 F.R.D. 486 (D. Neb. 1965); Heintz & Co. v. Provident Tradesmens Bank & Trust Co., 30 F.R.D. 171 (E.D. Pa. 1962); Bernstein v. N.V. Nederland-scheamerikaansche Stoomvaart-Maatschappij, 9 F.R.D. 557 (S.D.N.Y. 1949).

[36] *See, e.g.*, authorities cited note 29 *supra*.

[37] Note, *Federal Third-Party Practice—Ancillary Jurisdiction Supports Third-Party Defendant's Claim Against Plaintiff*, 8 UTAH L. REV. 145, 148 (1962). *But see* Frazer, *Ancillary Jurisdiction and the Joinder of Claims in the Federal Courts*, 33 F.R.D. 27, 42 (1963) [hereinafter cited as Frazer]

party, for the parties asserting these claims enter the lawsuit in different postures. The plaintiff, in bringing the action submits "himself to all claims arising out of the transaction which is the subject matter of the litigation,"[38] while "[t]he third-party defendant, on the other hand, is before the court involuntarily, and in all fairness he ought to be able to assert all claims arising out of the subject matter of the original action which he may have against the plaintiff."[39] Therefore, the policy considerations supporting ancillary jurisdiction call for its application to support the claim of the impleaded third-party against the plaintiff. Sufficient differences exist between these claims and plaintiff's claims against the third-party defendant to warrant different jurisdictional requirements.

Therefore, in *Revere* the court's extension of ancillary jurisdiction was absolutely correct, but several problems are inherent in the decision that need consideration. The first problem is how the plaintiff's response to the impleaded party's claim is to be categorized. Logically the response should be treated as a compulsory counterclaim under rule 13(a)[40] which, according to a majority of courts, would be supported by ancillary jurisdiction.[41] But here again the plaintiff will have succeeded in manufacturing his jurisdiction. A second inevitable problem is whether the threat of the collusive manufacturing of jurisdiction is so predominant as to require the avoidance of all other policy considerations supporting rule 14(a).[42] A pretrial agreement between the plaintiff and defendant to implead a third party is undoubtedly remote,[43] and such collusive alignment of parties to affect federal jurisdiction could be easily detected at the

[38] Note, 11 OKLA. L. REV., *supra* note 1, at 328.

[39] *Id.*

[40] FED. R. CIV. P. 13(a).

[41] *E.g.*, Great Lakes Rubber Corp. v. Herbert Cooper Co., 286 F.2d 631, 634 (3d Cir. 1961); United Artists Corp. v. Masterpiece Prod., Inc., 221 F.2d 213, 216 (2d Cir. 1955); 1A BARRON & HOLTZOFF § 392, at 548.

[42] Frazer at 42-43, where the author argues for an extension of ancillary jurisdiction to support plaintiff's claim against an impleaded party and concludes:

> Once a third-party defendant is brought into an action the court should be able to settle all claims arising out of the transaction that is the basis of the action, and it should be immaterial which party asserts the claim because the desirability of avoiding piecemeal litigation of disputes is as great whether the claim is asserted by a defendant or by a plaintiff. The parties and the facts are already before the court so that the burden on the court will not be increased by holding that the plaintiff's claim against the third-party defendant is ancillary.

[43] "That there may be collusion between the original parties in some cases should not prevent plaintiffs from asserting claims against third-party defendants in all cases. The courts should only dismiss the claim when collusion actually exists." *Id.* at 42.

initial stages of trial.[44] However, because of over-emphasis on the threat of jurisdictional collusion, precedent has developed requiring an independent jurisdictional ground.[45] Therefore, the extension of ancillary jurisdiction to cover the original plaintiff's claim against the impleaded party is less certain but arguably necessary if effect is to be given the policy behind the federal rules and if the courts are going to perform their primary function of settling the entire dispute.

E. L. KITTRELL SMITH

Constitutional Law—Right of Police to Retain Arrest Records

The advent of the computer, proposals for a new National Data Bank,[1] development of means for rapid and efficient interchange of information, and highly publicized incidents of police and military surveillance have crystallized public concern over the information retention activities of government agencies. This developing wariness of records would seem to germinate from their accelerated capacity for harm. At present, masses of records may be conveniently stored in computers subject to almost instantaneous recall. The data retained by one organization may be expeditiously conveyed to another on request.[2] The total effect of these technological advances is an increased potentiality for evil as well as good. The accuracy and validity of records that are damaging in nature must, therefore, be laboriously scrutinized if the interests of individuals are not to be crushed by a newly mechanized bureaucracy.

A recent federal case, *Menard v. Mitchell*,[3] outlined many of the competing considerations involved in the right of the police to keep records of arrests. The plaintiff brought an action seeking to compel the Attorney General and the Director of the Federal Bureau of Investigation to ex-

[44] At least another potential problem area has been avoided where the main claim is dismissed leaving only the third-party defendant's claim which lacks an independent jurisdictional base, for "[j]urisdiction once acquired is not lost by changes in the situation leaving only ancillary matters for determination." 1A BARRON & HOLTZOFF § 424, at 658.

[45] See note 29 *supra*.

[1] For an analysis of the advisability of a National Data Bank see generally J. ROSENBERG, THE DEATH OF PRIVACY (1969) [hereinafter cited as ROSENBERG].

[2] *Id.* 64-68.

[3] 430 F.2d 486 (D.C. Cir. 1970).

punge records[4] of his arrest and detention for burglary in California.[5] The Court of Appeals for the District of Columbia in reversing a summary judgment for defendants stated that the record was not sufficiently complete to permit summary judgment and remanded for a trial on the merits.

Since the court refused to surmise the actual nature of the facts in the case, the opinion dealt extensively with the entire question of arrest records. Appropriate dispositions were indicated for various hypothetical fact situations. Basically four fact situations which may be arranged in an order of ascending analytical complexity, are possible. An arrest may be made: 1) without probable cause for purposes other than prosecution, 2) in good faith but without probable cause, 3) with probable cause but further investigation proves exonerating, or 4) with probable cause but the prosecutorial process is not invoked. The import of *Menard* lies in the guidelines established for resolving the issue of the police right to retain records in these various contexts.

Arrests made for purposes other than prosecution are essentially punitive in nature.[6] Such arrests are employed as a substitute for the full criminal process when the criminal process is considered inappropriate or unavailable. In particular, prostitutes and those who violate liquor and gambling laws are vulnerable to arrests made on little or no actual evidence for the purpose of harassing their operations.[7] The Supreme Court in *United States v. Price*,[8] stated that "[i]f the Fourteenth Amendment forbids denial of counsel, it clearly denounces denial of any trial at all.[9] The court in *Menard*, relying on *Price*, severely questioned retention of records of arrests made for the purpose of harassing an individual.[10] Such a practice would constitute a nonjudicial punishment in violation of due process. The arrest record constitutes one aspect of the total punitive effect of an arrest when made solely for the purpose of achieving that effect. There-

[4] The FBI retains these records pursuant to the statutory authorization in 28 U.S.C. § 534(a)(1) (Supp. IV 1965-69).

[5] The plaintiff was released under CAL. PENAL CODE § 849(b)(1) (West 1970).

[6] *But see* United States v. Kelly, 55 F.2d 67, 70 (2d Cir. 1932), in which the court contended that compiling police records cannot be characterized as punishment.

[7] P. CHEVIGNY, POLICE POWER 219-35 (1969). Individuals may be arrested in order to maintain a proper level of respect for law enforcement officials. *Id.* at 89-98.

[8] 383 U.S. 787 (1966).

[9] *Id.* at 799.

[10] 430 F.2d at 494.

fore, memoralization of arrests in this first category is constitutionally defective for want of due process.

A strong constitutional argument may be made for precluding the retention of records of any arrest not resulting from probable cause and when probable cause never develops. A significant line of Supreme Court decisions has proscribed the use of "fruits" of an illegal seizure. In *Silverthorne Lumber Co. v. United States*[11] the government was prevented from using information gained by reviewing illegally seized documents. *Davis v. Mississippi*[12] prohibited the admission of fingerprints secured as a result of an unlawful detention. Finally, *Wong Sun v. United States*[13] established that verbal testimony ascertained to be the product of an unlawful arrest was inadmissible. In light of these cases the consideration narrows to a question of whether a record of an illegal—*i.e.*, without probable cause—arrest is the "fruit" of that arrest.

Since an arrest record has no independent significance and simply represents a transcription of the fact that an arrest occurred, a more direct product of an arrest is difficult to imagine. Significantly, an arrest record is employed primarily as an investigative aid—the precise use prohibited by the Court.[14] Admittedly, the record could be used only in investigation of subsequent criminal activity, but the prohibition established by *Silverthorne* was not confined to use in a particular case or point in time.[15] As a deterrent to illegal arrests, the police are restrained from any use of the products of such arrests. To permit the police to derive any benefit from an illegal arrest undermines the policy behind the exclusionary rule.[16]

When an arrest with probable cause terminates in exoneration, basic fairness would seem to preclude retention of a record. The court in *Menard* alluded to this question by reference to the fact that certainly no record could have been kept if an arrest had not occurred.[17] The import of this argument is that since the arrest resulted from a mistake, even though a reasonable one, it should not have occurred. Consequently, the police having initiated the mistaken arrest are under an obligation to restore the

[11] 251 U.S. 385 (1920).
[12] 394 U.S. 721 (1969).
[13] 371 U.S. 471 (1963).
[14] *See, e.g.*, Davis v. Mississippi, 394 U.S. 721 (1969).
[15] 251 U.S. at 392.
[16] *See* the rationale expressed concerning the exclusionary rule in Mapp v. Ohio, 367 U.S. 643, 659 (1961).
[17] 430 F.2d at 491.

individual as much as is possible to his position previous to the arrest.[18] The only legitimate police interest in this situation is based solely upon the need to maintain statistical data such as the number of arrests during a certain month. To facilitate this purpose, it is unnecesary for the record to disclose the identity of the individual. Administrative ease is not served by requiring two sets of records, one involving the identity, and the other not. Nevertheless, it would be inequitable to permit the police to take advantage of even an honest mistake to the detriment of an individual, administrative ease notwithstanding.

The most difficult problem concerns arrests resulting from probable cause in which the suspect is released but not exonerated. There are two facets to the resolution of this question. One concerns the dissemination of arrest records to potential employers. But even if dissemination to employers is not involved, a distinct problem remains as to whether the mere presence of the arrest records in the police files impinges vital rights.

Because police records, particularly those of the Federal Bureau of Investigation, are subject to substantial dissemination,[19] a person who has an arrest record may be handicapped in seeking employment.[20] This potentiality raises an equal protection question to which the court in *Menard* obliquely alluded.[21] In ascertaining whether the right to keep arrest records can withstand an attack based upon equal protection, the nature of the right infringed is significant. The question is whether the right is denominated as fundamental. In situations not involving fundamental rights, the government may make classifications so long as they are not arbitrary.[22] In such situations, those persons engaging in criminal activity are placed in this classification based upon having an arrest record. On the other hand, if fundamental rights are involved, the government must justify its classification with a "compelling" interest.[23] The Supreme

[18] For examples of liabilities that might result from an arrest record see Russell v. United States, 402 F.2d 185 (D.C. Cir. 1968) (refusal of personal recognizance); Rhodes v. United States, 275 F.2d 78, 82 (4th Cir. 1960) (government contended bail should be denied).

[19] *See* 28 U.S.C. § 534(a)(2) (Supp. IV 1965-69), for the authorized extent of dissemination. The ambiguity in the statutory phrase "other institutions" is clarified somewhat in 430 F.2d at 492 n.33.

[20] 430 F.2d at 490 n.17.

[21] [T]here is limit beyond which the government may not tread in devising classifications that lump the innocent with the guilty." *Id.* at 492.

[22] Railway Express Agency v. New York, 336 U.S. 106 (1949).

[23] Shapiro v. Thompson, 394 U.S. 618 (1969); See also Karst, *Invidious Discrimination: Justice Douglas and the Return of the "Natural-Law-Due-Process Formula,"* 16 U.C.L.A.L. REV. 716 (1969).

Court in *Levy v. Louisiana*[24] held that the right to adjudicate a wrongful death action involved the right of dependents to continued support and as such was "fundamental."[25] The analogy between the right of a family to receive continued support and the right to obtain gainful employment to provide similar support is clear. The inability to litigate a wrongful death would constitute a complete destruction of the the right involved in *Levy*. However, this aspect of *Levy* should not make the case distinguishable, even though the right to employment is only impaired by the dissemination of an arrest record. *Shapiro v. Thompson*[26] involved no more than an impairment of a right deemed fundamental—the right to travel—and not its complete destruction.

The court in *Menard* did not overtly come to grips with *Griswold v. Connecticut*[27] and its implications in the police record context. In *Griswold* the Supreme Court expanded the right to privacy beyond the bounds of the enumerated protections[28] and gave it an independent existence. The "constitutionalization" of the right to privacy in *Griswold* may have significant implications for the dissemination of police records. Underscoring this point is the fact that traditionally litigation concerning photographs and files maintained by the police was based upon the *equitable* right to privacy.[29] Many of these cases involved "rogue's gallerys"[30] which because of their accessibility to the public compromised this basic right.[31] While dispositions varied depending upon the significance given the right in the particular jurisdiction,[32] these state court decisions were pre-*Griswold*. The balancing of government and individual interests in

[24] 391 U.S. 68 (1968).

[25] *Id.* at 68-69.

[26] 394 U.S. 618 (1969).

[27] 384 U.S. 479 (1965).

[28] The enumerated rights to privacy are found in U.S. CONST. amends. I, II, IV, V. The right to association has been held to include the right to anonymity. NAACP v. Alabama, 357 U.S. 449 (1958).

[29] Cases cited note 32 *infra*.

[30] "Rogue's gallerys" are collections of photographs of persons who the police believe to have participated in criminal activity. These photographs are shown to members of the general public when they are attempting to identify the culprit of a crime.

[31] *See, e.g.*, Schulman v. Whitaker, 115 La. 628, 39 So. 737 (1905); Itzkovitch v. Whitaker, 115 La. 479, 39 So. 499 (1905).

[32] *Compare* State *ex rel.* Mavity v. Tyndall, 224 Ind. 364, 66 N.E.2d 755 (1946), Molineux v. Collins, 177 N.Y. 395, 69 N.E. 727 (1904), and Owen v. Partridge, 40 Misc. 415, 82 N.Y.S. 248 (1903) *with* State *ex rel.* Reed v. Harris, 348 Mo. 426, 153 S.W.2d 834 (1941), and McGovern v. Van Riper, 137 N.J. Eq. 24, 43 A.2d 514 (1945).

this area must now be reconsidered with cognizance being given to *Griswold.*

The government's interest in dissemination to employers is to protect employers from persons with criminal propensity. This interest is certainly less vital than the crime investigation interest which is not impaired by curtailment of dissemination. Further, given the unreliability of arrest records not resulting in conviction as an indicator of criminal propensity,[33] the government's interest could be characterized as weak indeed.

The court in *Menard* offered two suggestions for dealing with the problem of injury to employment opportunities. First, the records could be made more complete. It is doubtful, though, that even an arrest record stating "released because of insufficient evidence" would have a completely neutral effect upon an employer. The clear fact seems to be that arrest records of any type adversely affect job opportunities.[34] Even in *Menard* the court, while suggesting the need for more completeness, recognized the inherent difficulty in neutralizing arrest records.[35] The other alternative—curtailment of dissemination—provides the only effective means of preventing arrest records from infringing upon the rights of employment and privacy.

Even if arrest records are not disseminated, an argument can be made that the presence of a record in the police files infringes the right to privacy. A person with an arrest record is in a substantially different position vis-à-vis the police than other citizens. When a crime occurs, those persons with "records" are more likely to be investigated concerning that crime and if suspected, more likely to be arrested.[36] The increased efficiency and rapidity with which information may be disseminated among law enforcement entities and ultimately down to individual policemen enhances the possibility that an arrest record will result in investigation.[37] To the extent that an arrest record stimulates greater police involvement in the life of an individual, his privacy is diminished.

Despite an innate feeling that an arrest record somehow compromises

---

[33] See text p. 517-18 *infra.*

[34] "Mere arrest may destroy reputation, or cause the loss of a job, or visit grave injury upon a family." Breitel, *Controls in Criminal Law Enforcement,* 27 U. CHI. L. REV. 427, 431 (1960).

[35] 430 F.2d at 492-93.

[36] *Id.* at 490-91. See also W. LAFAVE, ARREST 287-89 (1965), and E. WILLIAMS, MODERN LAW ENFORCEMENT AND POLITICAL SCIENCE 105-09 (1967), which contain extensive analyses of reliance by the police upon information about past criminal activity.

[37] ROSENBERG 64-68.

privacy, it is difficult analytically to pinpoint the exact legal right invaded. Since an arrest is a public act, a record of the event cannot by its existence alone be an infringement upon privacy. Further, if the record influences the police to make subsequent forays into a person's privacy, those acts may be judged on their own merits. For example, a search, even though it might not have been made in the absence of the suspect's record, may be evaluated on the basis of its reasonableness at the time it occurred.[38] A finding of reasonableness legitimatizes any invasion of privacy caused by the arrest record. In short, it may be argued that the increased police scrutiny resulting from an arrest record does not impugn privacy unless the scrutiny itself is illegal. The legality of that scrutiny may be independently ascertained.

This contention, though compelling, it not completely persuasive. The police certainly do not investigate, search, or arrest every time there is legal justification to do so.[39] An unreasonably retained arrest record may constitute a significant criterion by which discretionary choices are resolved. Therefore, even though the act is reasonable, the catalyst for the act may not be. Arguably, an individual should be entitled to have police discretion concerning even legitimate incursions into his private life rest upon rational factors. The systematic introduction into the decision-making process of an irrational factor, in the form of an unreasonably retained arrest record, would seem, therefore, to constitute an infringement of the right to privacy. Further, a person has no remedy if the police search or detain him on the basis of an arrest record, and then release him. The fact that the subsequent act of invasion of privacy resulting from the record could theoretically be judged on its own merits becomes unimportant since no opportunity would arise to determine its reasonableness. The only realistic means of precluding these attacks on privacy is to eliminate the inaccurate record from which they stem.

An emerging pattern of state and federal court decisions limiting police surveillance[40] may also be relevant to police retention of criminal records. The United States Supreme Court has for some time looked disconsolately upon laws that exert a chilling effect on first amendment

[38] *See* Chimel v. California, 395 U.S. 752 (1969); Terry v. Ohio, 392 U.S. 1 (1968); Aguilar v. Texas, 378 U.S. 108 (1964).

[39] *See* Goldstein, *Police Discretion not to Invoke the Criminal Process: Low-Visibility Decisions in the Administration of Justice*, 69 YALE L.J. 543, 559-62 (1960).

[40] *See, e.g.*, Bee See Books Inc. v. Leary, 291 F. Supp. 622 (S.D.N.Y. 1968); Hicks v. Knight, 10 RACE REL. L. REP. 1504, 1505 (E.D. La. 1965) (prohibiting police from concealing identity).

rights.[41] A recent state court case[42] and an older federal case[43] extend to police surveillance the same type of rationale that is behind the "chilling effect" principle. These cases could portend important limitations upon police practices adversely affecting speech and association when the state interest is negligible or could be satisfied by a more circumscribed procedure.

The importance of this "chilling effect" doctrine is readily apparent in cases of arrest resulting from activities within the realm of first amendment applicability. An individual espousing viewpoints or participating in associations that the police consider "suspect" might well carry on these activities with far greater circumspection if he knew the police were aware of what he was doing. An awareness by the police based upon an arrest record for trespass during a "sit in," as an example, does not seem dissimilar from an awareness based on surveillance or police presence. In each case, the individual is more visible to the police than other persons. The individual's reaction to this enhanced visibility can inhibit the vigorous exercise of first amendment rights. Consequently, retention of the records of "political" arrests undermines a most crucial constitutional prerogative.

A somewhat strained argument may be made that the reason for the arrest does not affect the application of the "chilling effect" principle. The apprehension caused by an arrest record results from a reaction to the

[41] *E.g.*, United States v. Robel, 389 U.S. 258 (1967); Aptheker v. Secretary of State, 378 U.S. 500 (1964).

[42] Anderson v. Sills, 106 N.J. Super. 545, 256 A.2d 298 (1969), *rev'd*, 56 N.J. 210, 265 A.2d 678 (1970). The trial court held unconstitutional as unduly inhibiting first amendment rights a police procedure directed at gathering information about lawful activity looking toward civil disturbances; the reversal was based, however, to a significant extent upon the scantiness of the trial record and a belief that the lower court's injunction suffered from overbreadth. 56 N.J. at 215, 231-32; 265 A.2d at 681, 687. In addition to the rather narrow grounds for reversal and remand, the trial court decision remains important because of the validity of its logic. The trial court's holding would, without reversal, have been quite limited in its precedent effect. Therefore, the significance of the case is dependent on the persuasiveness of its reasoning. The lower court's opinion has been commented upon favorably in Askin, *Police Dossiers and Emerging Principles of First Amendment Adjudication*, 22 STAN. L. REV. 196 (1970); Schlam, *Police Intimidation Through "Surveillance" May be Enjoined as an Unconstitutional Violation of Rights of Assembly and Free Expression*, 3 CLEARINGHOUSE REV. 130 (1969); Note, *Constitutional Law—Illegality of Police Program to Gather Information on Civil Disorders*, 48 N.C.L. REV. 648 (1970).

[43] Local 309, United Furniture Workers v. Gates, 75 F. Supp. 620 (N.D. Ind. 1948), prohibited police attendance at a union meeting on the basis that such presence would inhibit the union members' exercise of their first amendment freedoms.

potentiality for intensified police scrutiny. Consequently, the fact of greater police awareness rather than its source is critical. Further, the failure of an individual to exercise the full range of his first amendment rights in the past does not justify a practice inhibiting their exercise in the future. However, the cause and effect relationship between possessing an arrest record for burgulary and refraining from unrelated associational actvities is tenuous.

The fact that arrest records cannot be reconciled with certain individual rights does not give rise to an absolute prohibition of record retention.[44] The equal protection, privacy, and first amendment considerations only indicate that there is something on the other side of the scales against which the state interest must be balanced. The files maintained by the police are used as a tool in the investigation of crime. Certainly, the government's interest in criminal investigation is compelling. However, this does not mean that the interest in keeping records of every arrest, even those based on probable cause, is sufficient to overcome the individual's interests.[45] The value of an arrest record as an investigative aid is based upon two assumptions: 1) the individual arrested did, in fact, commit the crime of which he is accused, and 2) his commission of this crime indicates a propensity to commit subsequent crimes. To the degree that a particular arrest record does not vindicate these assumptions, its value in police investigation is reduced and the government's interest in it wanes. At some point the government's interest is no longer sufficient to justify its infringement upon individual rights.

In ascertaining the extent of the government's interest in a particular case, the reason for the termination of the criminal process is critical. The police or the prosecutor may decide not to attempt prosecution for any number of legitimate reasons. Many of these reasons provide insights into whether the assumptions warranting keeping arrest records are founded in a particular case. If the evidence is insufficient to take the case to trial,[46] a record of such arrest would, at best, be of little value and could prove misleading. A substantial number of cases are not prosecuted

[44] The court in the principal case refused plaintiff's motion for a summary judgment. 430 F.2d at 490.

[45] See United States v. Kalish, 271 F. Supp. 968 (D.P.R. 1967). "[W]hen an accused is acquitted of the crime or when he is discharged without conviction, no public good is accomplished by the retention of criminal identification records." *Id.* at 970.

[46] This lack of evidence is one basis for release under CAL. PENAL CODE § 849 (b)(1) (West 1970).

because the prosecuting witness withdraws his complaint.[47] Many of these cases involve marital spats and insignificant conflicts between individuals who attempt to invoke the criminal process to salve injured feelings.[48] It is very doubtful whether such minimal criminal activity indicates any propensity to commit subsequent crimes. The same may be said for cases in which the police department or prosecutor makes an independent decision that the case is too trivial to be tried. These examples serve to illustrate situations in which the state interest on balance is not very compelling.

On the other hand, a failure to prosecute resulting, for example, from the death or unavailability of a crucial witness would not preclude a probability of actual guilt sufficient to necessitate keeping the record of arrest.[49] The overburdening of our court system may force prosecutors into hard choices concerning which cases to take to trial. A release resulting from inability to provide a speedy trial would not go to the merits of the case. As can be seen, each case must rest upon its particular facts. A single rule of generalized applicability is impossible. However, at a minimum, the police should be prevented from accumulating records on persons whose criminal activity is either very doubtful or insignificant.

The determination that certain criteria must be met for the retention of arrest records to be permitted is not alone sufficient. If the decision as to whether the standard has been satisfied simply becomes another aspect of the police and prosecutorial discretion, any protection for the right of privacy would be illusory. It is enlightening to note the means used to protect another constitutionally founded personal right. The police are required by inferences from the specific language in the fourth amendment to establish before an independent magistrate the necessity of searching a man's home.[50] The reason for this requirement is the inability of the police to objectivity balance the competing interests.[51] In addition, since the intrusion is a product of police activity, the police are required to sustain the burden of justification and initiate the process for judicial determination. The same rationale could support a requirement that an independent magistrate decide when the police may retain arrest records. The ease with which records of even insignificant value may be main-

[47] Note, *Prosecutor's Discretion,* 103 U. PA. L. REV. 1057, 1068 (1955).
[48] *Id.* at 1069.
[49] *Id.* at 1068.
[50] U.S. CONST. amend. IV.
[51] In Aguilar v. Texas, 378 U.S. 108 (1964), the Supreme Court held the police affidavit supporting a search warrant insufficient to establish probable cause.

tained would mitigate in favor of the police considering virtually all arrest records essential. An opportunity for a collateral attack upon the police discretion would be beyond the means of most individuals and, consequently, would not constitute a viable remedy. A procedure similar to that used in issuing search warrants would serve the dual purpose of providing objectivity and alleviating the necessity of the individual taking the initiative in protecting fundamental rights. In addition, a high visibility decision-making process would facilitate judicial establishment of standardized guidelines by which the close cases could be resolved. Admittedly, this procedure is not demanded by the language of the constitution. Nevertheless, the courts have traditionally been willing to require particular procedures when it is apparent they are essential to insure constitutionally protected rights.[52]

Constantly expanding capacity to secure and maintain massive quantities of data on individuals has placed the right to privacy on the cutting edge of the law. *Menard* represents the beginning of more intense judicial involvement in this area. However, a definitive demarcation by appellate courts of the boundaries of police rights in the record retention context is critical.

COY E. BREWER, JR.

Constitutional Law—The North Carolina Public Assistance Lien Law and Current Constitutional Doctrine

"Beneficient provisions for the poor, the unfortunate and orphan [is] one of the first duties of a civilized and Christian state . . . ."[1] Such was the philosophy of "welfare" when the framers wrote the North Carolina Constitution of 1868. By mid-twentieth century, however, the "beneficence" associated with public assistance in North Carolina was sharply curtailed for some groups among the poor. The change came with the enactment of North Carolina's first "welfare lien" laws.[2] For the first time in the state's history, public assistance was conditioned on eventual repayment through statutory liens on real property.[3]

[52] An excellent example of a procedure established by the courts to secure a constitutionally based right is that outlined in Miranda v. Arizona, 384 U.S. 436 (1966).

[1] N.C. CONST. art. XI, § 7 (1868).

[2] N.C. GEN. STAT. §§ 108-29 to -37.1 (Supp. 1969).

[3] As recently as 1969, thirty-three other states had some type of repayment provisions under federal-state funded programs. While such provisions are not required

Though there is a dearth of literature and case law on North Carolina's lien laws,[4] some of the federal constitutional doctrine that has evolved within the last two or three decades is highly relevant to the North Carolina statute and its administration. It is significant that the statute has never been challenged on constitutional grounds and that lien laws throughout the nation have generally escaped such a fate. The poverty of the potential litigants and their lack of adequate representation have made them for the present, at least, part of a silent minority. The important issues confronting North Carolina welfare legislation, however, can be highlighted by a brief examination of developing constitutional doctrine as it has related to other lien laws, welfare legislation generally, and allied fields.

In *Snell v. Wyman*[5] the United States Supreme Court affirmed without opinion a three-judge district court decision rejecting a challenge to the New York repayment law. Under the New York law, a person otherwise eligible for public assistance who owns real or personal property is deemed to have an "implied contract" with the welfare department for the full amount of assistance rendered.[6] Among the four plaintiffs in *Snell* was a nineteen-year-old mother with three children receiving AFDC payments. In 1967 she was involved in an auto accident, and as a condition to her continued receipt of public assistance, she was required to execute an "assignment of proceeds of lawsuit." This document served to assign the proceeds of her personal injury claim to the Department of Social Services.[7] Another plaintiff whose income was eighty-six dollars per week, and who was also receiving AFDC to help support his eight children, suffered personal injuries in the public housing project where he lived and was forced to quit his job. In 1967 this plaintiff received four hundred dollars from the New York City housing authorities as compensation for his injury,

by the states, and while the original Social Security Act was silent on state reimbursement, Congress has acquiesced to those states requiring repayment and now provides that a proportionate amount of money collected shall go to the federal government. HEW, CHARACTERISTICS OF STATE PUBLIC ASSISTANCE PLANS UNDER THE SOCIAL SECURITY ACT, PUBLIC ASSISTANCE REPORT No. 50 (1964 ed.).

[4] See R. Ligon, North Carolina Old Age Assistance Lien Law, March, 1960 (unpublished study located at the Institute of Gov't, Chapel Hill, N.C.).

[5] 393 U.S. 323 (1969) (per curiam), *aff'g*, 281 F. Supp. 853 (S.D.N.Y. 1968).

[6] N.Y. Soc. WELFARE LAW § 104 (McKinney 1966).

[7] 281 F. Supp. at 857. The Attorney General of North Carolina has stated that although proceeds from a wrongful death action are not "assets" of an estate under N.C. GEN. STAT. § 28-173, if the judgment of the court in a criminal prosecution for manslaughter directs that an amount of money be paid an administrator of the deceased-recipient, those funds do become assets of the estate that can be applied to an assistance claim. See R. Ligon, *supra* note 4, at 32.

but these funds were soon exhausted. The Department of Social Services required endorsement over of one of three disability insurance checks and asserted a "notice of lien" in the amount of 420 dollars for assistance furnished after the accident.[8] In addition to the liens on potential or actual recoveries for personal injuries, liens on an interest in real property and on an assignment of the interest of an insured recipient in life insurance policies were also involved.[9]

The plaintiffs argued that the repayment provisions were "arbitrary, oppressive, and irrational," that the state was defeating its own announced objective of seeking to make welfare recipients productive and self-supporting, and that the laws were contrary to the plaintiffs' own desires for human dignity and independence. They also argued that the state's only "conceivable rationale" for these laws was to save money but pointed out that in 1966 of 1,200,000,000 dollars spent for public aid, only 5,000,000 dollars was recovered through liens.[10]

In rejecting the due process arguments, the three-judge court stated that it could hold the statutes unconstitutional only if it were invested with a power under the due process clause to invalidate state laws on the basis that they might be "improvident" or "unwise."[11] Yielding to the Supreme Court's traditional nonintervention policy in cases in which the major impact is "economic," the court said:

> [I]t is not for federal judges to be "liberal" or "conservative" in advancing and ordering measures which undoubtedly related to basic matters of human decency. . . . The constricted test in this forum is one of minimal rationality.[12]

Plaintiffs also argued that they were denied equal protection since the state supplied many benefits for which it did not seek repayment and discriminated between those who had property and those who did not. With equal finesse the court blunted these arguments:

> Like the life of the law generally, the Fourteenth Amendment was not designed as an exercise in logic. It is ancient learning by now that a classification meets the equal protection test "if it is practical, and is not reviewable unless palpably arbitrary."[13]

---

[8] 281 F. Supp. at 858.
[9] *Id.* at 860.
[10] *Id.* at 861 n.16.
[11] *Id.* at 862.
[12] *Id.* at 863.
[13] *Id.* at 865. The California Supreme Court has held that the estate of a daughter could not be held liable for the mother's care at a state mental institution. The

Snell is significant because it is patently inconsistent with most of the equal protection standards established by the Supreme Court during the past quarter century, sometimes referred to as the "new" equal protection.[14] Where the impact of legislation has fallen on fundamental social concerns.[15] as opposed to purely economic relations, the Court has demanded a close analysis of several elements, including the legitimacy of the classification established by the law, the relationship between the classification and the purpose that the state is trying to promote, and finally, the validity of the state's purpose itself.[16] Professor Karst has summarized the constitutional effect of the new equal protection:

> What emerges from the new equal protection cases is an extremely flexible sliding scale for measuring the required degree of intensity

---

state's attempt to recover was deemed a denial of equal protection in that "the cost of maintaining the state's institution, including the provision of adequate care for its inmates, cannot be arbitrarily charged to one class in society." Department of Mental Hygiene v. Kirchner, 62 Cal. 2d 586, 400 P.2d 321, 43 Cal. Rptr. 329 (1965). For general commentary on welfare lien laws see Graham, *Public Assistance: The Right to Receive; The Obligation to Repay*, 43 N.Y.U.L. REV. 451 (1968); O'Neil, *Unconstitutional Conditions: Welfare Benefits With Strings Attached*, 54 CALIF. L. REV. 443 (1966); Comment, *Snell v. Wyman and the Constitutional Issues Posed by Welfare Payments Provisions*, 55 VA. L. REV. 177 (1969). For a biting attack on various state lien laws, in which the North Carolina statute is criticized, see SOUTH TODAY, July-August, 1970, at 4.

[14] See Horowitz & Neitring, *Equal Protection Aspects of Inequalities in Public Education and Public Assistance Programs from Place to Place Within A State*, 15 U.C.L.A.L. REV. 787 (1968); Karst, *Invidious Discrimination: Justice Douglas and the Return of the "Natural-Law-Due-Process Formula,"* 16 U.C.L.A. L. REV. 716 (1969).

[15] Outside the area of free expression, the Supreme Court has labeled the following as "fundamental" rights: voting, education, procreation, marriage, fairness in the criminal process, and the right to travel. Karst, *supra* note 14.

In Goldberg v. Kelly, 397 U.S. 254, 265 (1970), the Court declared welfare benefits a matter of "statutory entitlement" for those qualified. Justice Brennan, writing for the court, rejected the idea that public assistance was a mere charity, emphasizing that it was a "means to 'promote the general Welfare, and secure the Blessings of Liberty to ourselves and our posterity.'" Judge Frankel, writing for the three-judge court in *Snell* recognized that the "primitive needs of desperate people" is a different matter than purely economic concerns but refused to give such a difference constitutional distinction. The court added that its decision was in no way to be construed that welfare was not a "right" coming within the scope of the fourteenth amendment. 281 F. Supp. at 863 n.19.

[16] In cases in which classifications have been based on race, wealth or some other nonvoluntary status, the Supreme Court has insisted on a tight connection between the challenged legislation and the state's objective. A mere "rational" nexus is clearly insufficient. In such cases involving "fundamental" rights, the court will also weigh the state interests carefully, even if they concededly have validity. *See* Shapiro v. Thompson, 394 U.S. 618 (1969); Harper v. Virginia State Bd. of Elections, 383 U.S. 663 (1966).

> of judicial scrutiny of the legislative classification . . . . The more the victims of legislative classification appear to be disadvantaged, the less need there is for their interests to be basic. . . . The result . . . is not that the claim of constitutional right is absolute, but that it will prevail unless it is outweighed by a strong showing of justification by the state.[17]

The court in *Snell* clearly chose not to conform to the new equal protection formula,[18] though that formula has been adhered to in other cases dealing with welfare issues.[19] The inconsistencies that mark this area of the law, as well as other more stable constitutional doctrines, have important ramifications for the North Carolina welfare lien law.

North Carolina's first welfare lien law was created in 1951, but it applied only to aged persons receiving assistance.[20] In 1963 the General Assembly adopted a similar law applicable to those receiving aid under the permanently and totally disabled category,[21] and in 1969 the lien laws were amended and consolidated without significant change.[22] Assistance to those aged or disabled persons who owned any real property was conditioned on their agreeing to a lien for the amount of assistance which they might receive, while aid under the other federally and locally funded programs remained unconditional.[23] At the termination of the recipient's aid or at his death, the county department of social services determines the amount of real property owned by the recipient including that acquired subsequent to the lien; the department also determines if the recipient owns personal property worth over one hundred dollars. In the event the recipient or his estate satisfies *either* of these requisites, the county department prepares a report, and the county attorney then enforces the lien.[24] Unlike the New

[17] Karst, *supra* note 14, at 744-45.

[18] In another case involving the state's discretion in allocating welfare funds, the Court recognized that public assistance "involves the most basic economic needs of human beings" but followed *Snell* in applying minimum rationality standards. Dandridge v. Williams, 397 U.S. 471, 485 (1970).

[19] Goldberg v. Kelly, 397 U.S. 254 (1970); Shapiro v. Thompson, 394 U.S. 618 (1969).

[20] N.C. GEN. STAT. § 108-30.1 (1966).

[21] N.C. GEN. STAT. § 108-73.12a (1966).

[22] N.C. GEN. STAT. §§ 108-20 to -37.1 (Supp. 1969).

[23] Recipients of Aid for Dependent Children (AFDC), Aid to the Blind (AB), and those receiving "general assistance" money are unaffected by the lien laws.

[24] N.C. GEN. STAT. §§ 108-36, -37 (Supp. 1969). The liens are renewable provided the recipient continues to receive public assistance and an additional statement is filed and properly indexed. Once the assistance terminates the lien is not renewable, and no action may be brought to enforce the lien more than ten years after the last day on which assistance was paid nor more than three years after

York lien statute, which provides for an implied contract between the department of social services and the recipient, the North Carolina law places a "general claim and a lien" on the real property of the person. The state courts have held that when the recipient dies the claim must first be satisfied from personal property in the same manner other claims against the estate are satisfied. When the personal property is insufficient, the real property is sold to satisfy the obligation.[25]

Whether the North Carolina statute as presently administered could withstand the Court's rigorous scrutiny under the "new" equal protection doctrine, or even meet some of the relaxed standards as expressed in *Snell* is open to debate. While the Supreme Court has said that where the state regulates or interferes with fundamental freedoms, " '[p]recision of regulation must be the touchstone,' "[26] the major infirmity of the North Carolina law rests in its lack of precision, both in framing and administration.

It is significant that the majority in *Snell* recognized the need for some precision with regard to the nature of the property that could be subject to the liens. Acknowledging that there are administrative qualifications upon the state's right to recover, the court pointed out that except in cases of fraud, no reimbursement is sought from property acquired by earnings after a recipient has gone off welfare. The fact that such earnings are exempted, in the words of the court, "leave wholly unfettered the desire and search for independence through gainful work."[27] The New York statute was designed to catch primarily "windfall" property, *i.e.*, any property not "gainfully earned."

---

the date of the recipient's death. N.C. GEN. STAT. § 108-33 (Supp. 1969). No enforcement is possible as long as the recipient, or after his death his surviving spouse, dependent minor child, or dependent adult child with a mental or physical disability (and incapable of self-support) is occupying the property as a homesite. N.C. GEN. STAT. § 108-34 (Supp. 1969).

[25] Brunswick County v. Vitou, 6 N.C. App. 54, 169 S.E.2d 234 (1969). The Attorney General has given his opinion that the former old age assistance lien did not apply to property held by the entirety, although it does apply to tenancies in common. See Letter from Attorney General to W.E. Bateman, subject: S.M. Woodley, 89-448-1249; Assistance Lien; Tenancy by the Entirety; Tenancy in Common; dated 24 May 1967. (On file at the Institute of Gov't, Chapel Hill, N.C.). N.C. GEN. STAT. § 108-31 (Supp. 1969), makes the filing of the lien "due notice" to the recipient of the obligation against his real property.

[26] Griswold v. Connecticut, 381 U.S. 479, 498 (1965), *quoting* NAACP v. Button, 371 U.S. 415, 438 (1963).

[27] 281 F. Supp. at 862. Judge Kaufman, dissenting in *Snell*, was dissatisfied with the majority's view that the administrative qualifications were adequate, choosing not to discern merely between property "gainfully earned" and other

The North Carolina statute makes *no* distinction between "windfall" and earned property but subjects *all* property, earned or otherwise acquired, to the claim or lien.[28] The only "precision" required by North Carolina is that personal property be exhausted before realty, and that mandate is not even statutory.[29] The rationale for North Carolina's lack of precision in determining which property is susceptible would seem to be that those who are aged or permanently and totally disabled no longer enjoy an "earning capacity" at the time they receive public assistance, and that there is only a minimal chance that such persons will gainfully earn any property after receiving aid. This does not, however, explain the consequences of the liens upon property gainfully earned before the relief is sought.

The administration of the welfare lien in North Carolina is left almost totally in the hands of the counties, and the county attorneys enforce the law at the appropriate time. There is evidence that enforcement throughout the state is not uniform and that in at least one county the lien laws are not enforced at all.[30] An amendment to the law in 1969 gave the Boards of County Commissioners discretionary power to release any lien if, in its opinion, such a release would result in a larger net recovery for the county, state and federal governments.[31] It is clear that unevenness of administration raises constitutional questions even under "traditional" equal protection notions.

The Supreme Court has held that a state, in deciding whether laws shall operate statewide or only in selected territories, has great latitude.[32] Territorial uniformity is not a constitutional requirement, and the legislature is free to determine priorities for its local subdivisions.[33] Such broad discretion applies to welfare payments, and the state may allocate its resources as it sees fit provided there is a rational basis.[34] A state, however, may not "purposefully" discriminate in applying an otherwise uniform law. The constitutional principle was set out in *Snowden v. Hughes*:[35]

property. He suggested that the guide for the welfare officials should not be the "mere *availability of some property* but a genuine *ability to repay* without sacrificing the basic incidents of self-support." *Id.* at 873.

[28] N.C. GEN. STAT. §§ 109-29, -35 (Supp. 1969).

[29] See text preceding note 25 *supra.*

[30] Yancey County has not enforced the lien law since 1958 according to one social services official. "Local politics" was the only explanation given.

[31] N.C. GEN. STAT. § 108-37.1 (Supp. 1969).

[32] Salsburg v. Maryland, 346 U.S. 545 (1954).

[33] *Id.* at 552.

[34] Dandridge v. Williams, 397 U.S. 471, 487 (1970).

[35] 321 U.S. 1 (1944).

> The unlawful administration by state officers of a state statute fair on its face, resulting in its unequal application to those who are entitled to be treated alike, is not a denial of equal protection unless there is shown to be present in it an element of intentional or purposeful discrimination. This may appear on the face of the action taken with respect to a particular class of persons . . . or it may only be shown by extrinsic evidence showing a discriminatory design to favor one individual or class over another not to be inferred from the action itself.[36]

Since *Snowden* the Court has stated that "discrimination-in-fact" is bad even when it "reflects *no* policy, but simply arbitrary and capricious action."[37] This would apparently condemn inefficient or haphazard administrative action, even if not intentionally discriminatory.[38] There has been some suggestion that even purposeful and apparently rational variations within a state may be subject to closer scrutiny if the interests involved are "fundamental":

> Even though . . . territorial variations may not always constitute a denial of equal protection there may be less justification for such a permissive attitude where interests such as education are involved. To be constitutional variations of this kind have to be shown to be essential to some overriding state interest.[39]

An equally important question connected with the "new" equal protection doctrine, and one which involves the North Carolina statute, is the determination of when the judiciary will look behind the "purpose" of the legislation to analyze the "motives" of the legislature. Early constitutional doctrine shunned looking to the "motives" of Congress, as this was deemed a violation of the separation of powers principle.[40] In later years, however, the Supreme Court has at least given a hard look at the underlying purpose if not the motives behind some legislation, namely that serving to maintain school segregation[41] or foster racial discrimination in voting.[42]

---

[36] *Id.* at 8, *citing* Yick Wo v. Hopkins, 118 U.S. 356, 373-74 (1886).

[37] Baker v. Carr, 369 U.S. 186, 226 (1962).

[38] J. Skelly Wright, writing for the District Court for the District of Columbia, has denied that deliberate discrimination is essential for a violation of equal protection. "[G]overnment action which without justification imposes unequal burdens or awards unequal benefits is unconstitutional." Hobson v. Hansen, 269 F. Supp. 401, 497 (D.D.C. 1967).

[39] *Developments in the Law—Equal Protection*, 82 HARV. L. REV. 1065, 1096 (1969).

[40] Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810).

[41] See Griffin v. County School Bd., 377 U.S. 218 (1964); Hall v. St. Helena

The ostensible purpose of the North Carolina lien law is to reimburse county and state treasuries for aid to the aged and disabled, thus allowing more qualified poor persons to receive assistance. However, a brief review of some of the statistics supplied by the Department of Social Services casts doubt on this assumption.[43] For the period beginning July 1, 1970, and ending December 31, 1970, the net collection for all North Carolina counties reporting lien collections was 234,354 dollars. Fifty-two out of one hundred counties collected old age assistance liens, and thirty-eight collected disability liens during this period. From the total, the amount returned to the federal government was 186,167 dollars, or nearly eighty per cent. The state and counties then split the remainder equally—24,093 dollars going to the state treasury and an average of 395 dollars left for each of sixty-one counties, the total number of counties reporting lien collections.[44]

Contrasting the total contributions to the two programs by the state and the counties with the lien reimbursements during the six month period, the latter appears miniscule. According to the Department of Social Services, the total amount expended by the state and counties for the period was 6,655,022 dollars for the two assistance programs.[45] Thus, the total liens collected comprised only 3.5 per cent of the amounts expended by the state and counties for public assistance; but since eighty per cent of that amount collected was returned to the federal treasury, only 0.72 per cent expended by the state and counties was actually recouped by them through the liens.

The conclusion to be drawn from an overview of the statistics is that reimbursement is not the only or perhaps not even the major reason for the continuation of the liens. The federal government and the taxpayers in all fifty states are the benefactors of lien collections in North Carolina.

Parish School Bd., 197 F. Supp. 649 (E.D. La.), *aff'd per curiam*, 368 U.S. 515 (1962).

[42] Davis v. Schnell, 81 F. Supp. 872 (S.D. Ala.), *aff'd per curiam*, 336 U.S. 933 (1949). See generally *Developments in the Law—Equal Protection, supra* note 39, at 1091-1101.

[43] The statistics appearing herein were made available upon request from the Finance and Budget Section of the Department of Social Services, Raleigh, North Carolina.

[44] Nine of the thirty-eight counties reporting collections of disability liens did not collect old age liens. Attorneys' fees for the collection of the liens totaled 37,698 dollars over the six-month period, well over 100 percent of the total amount returned to the counties that enforced the claims.

[45] 3,342,802 dollars were expended on old-age assistance and 3,312,219 dollars on aid to the disabled. The state and counties each contributed fifty percent of the total.

The only fair deduction is that the liens are intended to deter the aged and permanently and totally disabled from seeking public assistance. In view of the fact that welfare assistance is now regarded as a "statutory entitlement"[46] instead of a charitable privilege it is questionable whether such deterrence is constitutionally permissible. Even by rational standards, classifying the aged and the disabled into such a category would hardly stand analysis if deterrence is in fact a purpose behind the laws. It is significant in this regard that those receiving "general assistance" in North Carolina are persons ineligible for one of the federally-supported categorical public assistance programs, and *all* of the funds for general assistance must be raised at the county level at the discretion of the county commissioners.[47] Though the need for reimbursement would seem critical at the local level no lien laws are applicable. Clearly, if North Carolina's primary purpose in enforcing the lien is to provide reimbursement, the present law is wholly unsatisfactory.

A narrow reading of recent judicial decisions would indicate that welfare repayment laws, at least in the short run, will remain immune from attack by the courts. A broader view of recent equal protection doctrine, however, both in the welfare field and in other areas where disadvantaged persons and fundamental rights are concerned, suggests that such immunity may not endure.[48] North Carolina's statute is vulnerable to an attack under the new equal protection doctrine because of the imprecision in its composition, the lack of uniformity in its enforcement and the failure of the state to achieve its purported purpose. An analysis of the statute and its administration lead to the conclusion not only that its provisions raise constitutional questions but that its preservation is due to political expediency rather than fiscal responsibility.

GARBER A. DAVIDSON, JR.

[46] Goldberg v. Kelly, 397 U.S. 254, 262 (1970).

[47] M. Thomas, Jr., *A Guide To Social Services in North Carolina* 34 (1970). The author cites authority for the fact that North Carolina was forty-first in the nation in 1968 in per capita annual income and that there are many needy people who are ineligible because they do not meet all of the qualifications established. He gives as an example a father earning sixty dollars per week who is living in the home with his wife and six children. His children are ineligible for AFDC because they have not been deprived of parental support. *Id.* at 32.

[48] *But see* Wyman v. James, 39 U.S.L.W. 4085 (U.S. Jan. 12, 1971), in which the court rejected a fourth amendment challenge to a New York regulation which requires home visits as a condition for receiving assistance. This decision may portend a movement away from the "new" equal protection approach in welfare cases. *But cf.* Note, *Poverty Law—Is a Search Warrant Required for Home Visitation by Welfare Officials?* 48 N.C.L. REV. 1010 (1970) (author reached a contrary conclusion in writing on the court of appeals decision).

Environmental Law—Control of Pesticides: Proposals for a New Law in North Carolina

Increasing disquietude over the use of pesticides—growing ever since the publication of Rachel Carson's SILENT SPRING in 1962—has recently plunged conservation, wildlife, agricultural and industrial organizations as well as federal and state agencies into an uproar. A flurry of resolutions, proposals, solutions, hearings, law suits and legislation has ensued. Some conservationists would have us believe that unless pesticides are completely banned, we are faced with destruction. On the other hand, those who advocate pesticide use claim that without free use of pesticides we will certainly starve. Pesticide use appears to be on the increase[1] and voluminous studies on the various aspects of pesticides conducted by agricultural, scientific and environmental concerns across the country all point to the fact that pesticides, in some way, are affecting our environment.[2]

Chlorinated hydrocarbons, or persistent pesticides, form the principle arena of the pesticide use/abuse controversy. It is ironic that DDT, a member of this family, often a focal point of the furor and condemned by many as an ecological disaster, was once hailed as a miracle chemical.[3] Other members of this notorious group are DDE and TDE (metabolites of DDT), endrin, aldrin, dieldrin, heptachlor, chlordane, toxaphene and lindane.[4] These chemicals share four characteristics that distinguish them from less controversial pesticides: 1) they do not break down rapidly under natural conditions but remain in the environment for long periods,

[1] There are currently more than sixty thousand pesticide formulations registered for sale in the United States. S. BLOOM & S. DEGLER, PESTICIDES AND POLLUTION 4 (1969) [hereinafter cited as BLOOM & DEGLER]. The amount of money spent by farmers for pesticides has grown at the rate of fifteen per cent a year since 1950 (from eighty-seven million dollars to over one billion dollars in 1968). In 1968, farmers spent 3.65 dollars per acre on pesticides. By 1975, this figure is expected to rise to eight to nine dollars per acre. Consumer sales for pesticides, estimated at 1.7 billion dollars in 1968, should reach by 1975 the three-billion-dollar mark. CHEMICAL WEEK, April 12, 1969, at 38. The United States produced 1,050 pounds of pesticidal chemicals during 1967. BLOOM & DEGLER 1.

[2] For extensive bibliographies of these studies, see HEW, REPORT OF THE SECRETARY'S COMMISSION ON PESTICIDES AND THEIR RELATIONSHIP TO ENVIRONMENTAL HEALTH, pts. I & II (1969) [hereinafter cited as MRAK REPORT].

[3] Rogers, *The Persistent Problem of the Persistent Pesticides: A Lesson in Environmental Law*, 70 COLUM. L. REV. 567, 574 (1970) [hereinafter cited as *Persistent Pesticides*]; MRAK REPORT 44-46.

[4] MRAK REPORT 8-9; E. Bricklemyer & M. Heath, Regulation of Pesticides in the United States 2 (1970) (on file at the Institute of Government, Chapel Hill, N.C.); Environmental Clearinghouse, Inc., Memorandum on Pesticides, July, 1970.

i.e., they are nonbiodegradable; 2) they tend to be toxic in some degree for any form of life; 3) they are selectively stored in animal tissues; and 4) they are easily transported through the environment.[5] Damage to several species of birds, fish and wildlife has been documented,[6] but much of the research is incomplete, and little is known of the long term effects of pesticides on man.[7] The problem is not only what to do, but what can be done, and how to do it. This note will briefly discuss federal regulation in the field of pesticides, the existing legislation in North Carolina for pesticide control and the recommendations of the North Carolina Legislative Research Commission for new regulation.[8]

Federal Regulation

The major vehicle for federal pesticide regulation is the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA),[9] which requires registration of any product sold in interstate commerce that is classified as an "economic poison."[10] The registration process is conducted by the

[5] Remarks of Dr. Don W. Hayne reported in *Hearings on the Use and Control of Pesticides Before the Subcommittee on Pesticides of the Legislative Research Commission*, 1969 N.C. Gen. Ass'y at 3 (Jan. 23, 1970) (this report and all other hearings are on file at Institute of Government, Chapel Hill, N.C.).

Perhaps the most frightening characteristic of persistent pesticides involves the process of biological magnification, wherein the concentration of pesticide residue in an animal's tissues is considerably higher than the concentration in the food it eats. Humans, for example, store DDT in fat tissues at a concentration of approximately eleven parts per million (ppm) (three to four ppm on basis of whole body weight). This same DDT is concentrated in the total human diet at about 0.1 ppm—thus, magnification of about thirty-five fold. *Id.* at 5.

A startling illustration of the sometimes damaging results of biological magnification occurred in 1957 in California when Clear Lake was sprayed for gnat control with DDT at a maximum concentration of 0.02 ppm. The magnification proceeded through plankton, plankton-eating fish, carnivorous fish and fish-eating birds. It was discovered later when grebes began dying at an alarming rate that these birds contained a concentration of up to 1,600 ppm DDT and that some fish had built up over 2,275 ppm of DDT in their fat, a magnification of 100,000. *Hearings on the Use and Control of Pesticides Before the Subcommittee of Pesticides of the Legislative Research Commission*, 1969 N.C. Gen. Ass'y at 57 (March 20, 1970).

[6] Mrak Report 177-228.

[7] *Id.* 229-458.

[8] These recommendations are based on hearings conducted by the commission. *Hearings on the Use and Control of Pesticides Before the Subcommittee on Pesticides of the Legislative Research Commission*, 1969 N.C. Gen. Ass'y (Jan. 23, 1970; March 20, 1970; April 17-18, 1970; May 22, 1970; June 4, 1970; June 10, 1970; July 11, 1970) [hereinafter respectively cited as *January Hearings, March Hearings, April Hearings, May Hearings, June 4 Hearings, June 10 Hearings,* and *July Hearings*].

[9] 7 U.S.C. §§ 135-135k (1964).

[10] An economic poison is defined as "(1) any substance or mixture of sub-

Pesticides Regulation Division of the United States Department of Agriculture (USDA).[11] Besides submitting fairly detailed information for registration, manufacturers must devise an appropriate label for the product.[12] Although registration applications are reviewed by the Food and Drug Administration (FDA), the Public Health Service, the Department of the Interior (USDI) and, since 1964, the Department of Health, Education and Welfare (HEW), these agencies' participation is in an advisory capacity only.[13] The statute provides for seizure where products have been adulterated, misbranded, unregistered or insufficiently labeled and for criminal fine or imprisonment as an additional enforcement method.[14] Supplementing the FIFRA is the Food, Drug and Cosmetic Act (FDCA) which requires that the Secretary of HEW establish tolerances for residues from registered pesticides in food products.[15]

After public outcry following the April, 1969, seizure of twenty-eight thousand pounds of salmon containing DDT in excess of established tolerance levels, the Secretary of HEW formed a commission to study pesticides.[16] The result was the well-known Mrak Report, containing recommendations urging various corrective action at the federal level in order to provide more adequate controls for sale and use of pesticides.[17]

---

stances intended for preventing, destroying, repelling, or mitigating any insects, rodents, nematodes, fungi, weeds, and other forms of plant or animal life or viruses, except viruses on or in living man or other animals, which the Secretary shall declare to be a pest, and (2) any substances or mixture of substances intended for use as a plant regulator, defoliant or desicant." 7 U.S.C. § 135 (1964).

[11] BLOOM & DEGLER 39. Recent reorganization has placed responsibility for all laws relating to pesticides in a new Environmental Protection Agency.

[12] For a list of these requirements, see *id.* 41-43.

[13] *Id.* 39. Because of this lack of veto power, hundreds of pesticides have been registered over the objections of HEW. *Persistent Pesticides* at 570, citing HOUSE COMM. ON GOV'T OPERATIONS, DEFICIENCIES IN ADMINISTRATION OF THE FEDERAL INSECTICIDE, FUNGICIDE AND RODENTICIDE ACT, H.R. No. 637, 91st Cong., 1st Sess. 14 (1969).

[14] 7 U.S.C. §§ 135f, g (1964).

[15] 21 U.S.C. §§ 341-348 (1964). Significant FDCA amendments are the Miller Amendment of 1954 (21 U.S.C. § 364a, b (1964)), allowing condemnation of agricultural commodities if they contain a residue not exempted or in excessive amounts; and the "Delaney" Clause (21 U.S.C. § 348c(3)(A) (1964)), permitting no material in food capable of causing cancer. Enforcement of the FDCA has also been transferred to the Environmental Protection Agency. See note 10 *supra.*

[16] *Persistent Pesticides* at 567. For full title of the commission and its report, see note 2 *supra.*

[17] The more important of the commission's fourteen comprehensive recommendations include: eliminating all uses of DDT and DDD within two years, except those essential to preservation of human health or welfare; requiring unanimous appoval of USDA, USDI, and HEW of any registration, restricting or eliminating any pesticide use deemed hazardous by one; restricting other persistent pesticides

In response to the Mrak recommendations, the USDA announced on November 20, 1969, the cancellation of registrations for any products containing DDT for uses on shade trees, tobacco, around the home and by persons other than public officials in aquatic areas and wetlands.[18] Whether the Mrak Commission recommendations will ever be effectively instituted remains to be seen.[19] Meanwhile, several conservation groups have taken matters into their own hands by instituting legal actions aimed at various problems of pesticide control and use.[20]

CURRENT NORTH CAROLINA LAW

In addition to federal controls, all of the states, including North Carolina, have enacted some form of pesticide legislation. Adapted from a model act, the North Carolina Insecticide, Fungicide and Rodenticide Act (IFRA)[21] is administered by the State Department of Agriculture and, like the federal act, provides for registration of any "economic poisons"[22] and deems it unlawful for any person to sell an unregistered,

to uses that present no known hazard to human health or environmental quality; improving coordination and direction of the elements of HEW concerned with pesticides; creating a pesticides advisory committee to evaluate data on the hazards of pesticides to human health and environmental quality; developing standards for pesticide content in food, water and air that will protect the public from undue hazards; increasing federal support of research on all methods of pest control; and developing model regulations for collection and disposal of unused pesticides, containers and other contaminated materials. MRAK REPORT 7-19.

[18] The department also declared an intent to cancel any other use of DDT unless it is shown that a particular use is essential to protect human health and that there is no effective and safe substitute. 34 Fed. Reg. 18827 (1969).

[19] *See generally Persistent Pesticides* for a detailed, critical discussion of the Mrak recommendations and their chances for success, in light of past federal action.

[20] The most virulent and aggressive of these has been the Environmental Defense Fund. *See, e.g.*, Environmental Defense Fund v. Finch, 428 F.2d 1083 (D.C. Cir. 1970), in which the Secretary of HEW was ordered to consider a petition to set "zero tolerance" levels for DDT and study scientific evidence and safe tolerance levels in light of the FDCA, and Environmental Defense Fund v. Hardin, 428 F.2d 1093 (D.C. Cir. 1970), in which the Secretary of Agriculture was given thirty days to begin cancellation proceedings for DDT or show cause for refusal. Reasons were filed and further argument was set for a later date. Final judgment came January 7, 1971, when the court ordered the administrator of the Environmental Protection Agency (added as a defendant when the FIFRA was removed from the USDA) to issue immediate notices of cancellation of all uses of DDT and "to determine whether evidence that DDT was an 'imminent hazard' to public health required . . . the immediate suspension of all interstate shipments of DDT pending the outcome of lengthy concellation proceedings." Raleigh News and Observer, Jan. 8, 1971, at 1, col. 1.

[21] N.C. GEN. STAT. §§ 106-65.1-.12 (1966).

[22] N.C. GEN. STAT. § 106-65.5 (1966).

improperly labeled, "adulterated" or "misbranded" product.[23] The Commissioner of Agriculture can cancel any registration if the registrant has tried to evade any of the provisions of the act[24] and may enforce the act by injunction,[25] criminal action,[26] "stop sale" orders,[27] or seizure of the chemical.[28] In addition, the Board of Agriculture can make any rules or regulations relating to the sale and distribution of economic poisons that it thinks necessary.[29]

Another regulatory control is the Structural Pest Control Law,[30] which covers all means of controlling termites and household pests and requires commercial applicators to be licensed and pass an examination. Also of possible applicability is the Food, Drug and Cosmetic Act, which defines food as adulterated "[i]f it . . . contains any poisonous . . . substance which may render it injurious to health [or] . . . any added . . . substance which may be unsafe."[31] Although the provisions do not explicitly mention pesticides, they could be interpreted as pertinent. However, since the Commissioner of Agriculture enforces both the FDCA and the IFRA, the FDCA has never been used for pesticide control. An additional statute invoked in the past in regard to pesticides is the North Carolina "fish-kill" law,[32] which allows the Board of Air and Water Resources to investigate fish kills resulting from water pollution and to collect damages in the name of the state. Finally, the Aerial Crop-Dusting Law[33]

[23] N.C. GEN. STAT. § 106-65.3 (1966). Under the present statute, the best method for limiting a use of a pesticide appears to be by application of the prohibition of misbranding. The definition of "misbranded" includes any economic poison if the labeling does not contain instructions adequate for the protection of the public, or if the label does not have a warning needed to prevent injury to man or animals, or if when used as directed, it is harmful to man, animals, or vegetation to which it is applied. N.C. GEN. STAT. § 106-65.2 (1966).

[24] N.C. GEN. STAT. § 106-65.5(e) (1966).

[25] N.C. GEN. STAT. § 106-65.4 (1966).

[26] N.C. GEN. STAT. § 106-65.7 (1966).

[27] N.C. GEN. STAT. § 106-65.10 (1966).

[28] N.C. GEN. STAT. § 106-65.11 (1966).

[29] N.C. GEN. STAT. § 106-65.6(c) (1966).

[30] N.C. GEN. STAT. §§ 196-65.22-.35 (1966).

[31] N.C. GEN. STAT. § 106-129 (1966).

[32] N.C. GEN. STAT. § 143-215.3(a)(7) (1966). Perhaps the most serious of reported fish kills was the July, 1968 kill on the Cape Fear River, where more than 7000 pounds of fish were poisoned by endrin. Fortunately, the polluter was identifiable, and eventually paid 15,800.89 dollars in damages. The pollution in this case was caused by the polluter's own misuse and carelessness when he dumped leftover endrin into a storm sewer. *March Hearings* at 61. Unhappily, the successful cases are somewhat rare; more often it is impossible to determine the source of pollution.

[33] N.C. GEN. STAT. §§ 106-65.13-.22 (1966).

licenses commercial applicators who use airplanes and regulates aerial application of pesticides.

These statutes are administered by responsible officials who willingly receive and accept competent advice from the experts at our state universities. However, the statutes are more pertinent to informational objectives and to protection of the consumer rather than to control of the use of pesticides, and represent at best, a somewhat sketchy regulatory structure. There is, for example, no existing statute to restrict the use of pesticides. Once registered, a pesticide can be legally sold and used without limitation, even for purposes for which registration would have been refused. Another problem is that there are no statutory mandates for persons who sell pesticides. It is estimated that seventy percent of the farmers in North Carolina receive their information on proper application of pesticides from dealers,[34] yet the dealers themselves are not compelled to obtain any knowledge of the products they sell, and there is no means of assuring that their advice is accurate. The commissioner has stated that he has no way of knowing the volume of pesticides sold or currently in use throughout the state.[35] Surely this information would be valuable for maintaining adequate control over distribution of pesticides, for preventing abuses and for providing much needed data for research. Furthermore, misuse of pesticides—in application and in careless disposal of unused and contaminated materials—is regarded as a major source of problems with pesticides,[36] but there are no statutes respecting disposal nor is there any control over some of the major groups of applicators. Finally, although the misbranding section of the IFRA seems to contain adequate authority for cancelling uses of pesticides,[37] more explicit power to cancel or ban is desirable.[38]

---

[34] *April Hearings* at 42.

[35] *June 4 Hearings* app. A, at 5.

[36] See generally, *March Hearings* apps. B, I; *April Hearings* at 49 & app. K. Mr. Jacob Koomen, Director of the State Board of Health cited several trends in rural pesticide use based upon a survey of 250 farms in one North Carolina county: a) most pesticides are applied by farmers rather than custom applicators; b) excessive noncompliance is evident regarding appropriate disposal of unused pesticides and their containers; c) pesticides are often stored hazardously; d) few farmers wear protective equipment when applying pesticides; and e) rural water supplies are often inadequate to protect against pesticide contamination. *March Hearings* app. I, at 3.

Many conservation groups, however, do not believe that the only damage done to the environment by pesticides is a result of misuse. *See, e.g., March Hearings* at 61-62.

[37] N.C. GEN. STAT. § 106-65.7 (1966).

[38] On December 22, 1969, the Commissioner of Agriculture declared that in

Recommendations for New Legislation

North Carolina has not been unaffected by the wide controversy over pesticides. In response to the many questions raised over the proper manner to control the use of pesticides, the 1969 North Carolina General Assembly requested the Legislative Research Commission "to study agricultural and other pesticides" and report its findings to the 1971 general assembly.[39] These duties were delegated to a subcommittee which held hearings for several months,[40] collected volumes of data and prepared a thoughtful and well-researched report containing its recommendations for new legislation.[41]

The Legislative Research Commission proposed new legislation affecting organization, regulation, monitoring and research, and financing. In the area of organization, the commission advised the creation of a new five-member pesticide board composed of one representative each from the Departments of Agriculture and Health and a conservation agency and two citizens-at-large.[42] Administration and enforcement of the program will remain within the Department of Agriculture. A further proposal would establish an eleven member advisory committee of specified composition to consult and advise the board and the commissioner on technical matters.[43]

1970 the department would not register DDT for any of the uses cancelled by the USDA (see note 18 *supra*) and furthermore, would not register for use on tobacco any labels containing DDD (TDE), aldrin, dieldrin, heptachlor, chlordane, or lindane. For a copy of this order, see *July Hearings* app. C. The Attorney General advised that the IFRA misbranding section was applicable, but the commissioner stated that he would prefer more specific authorization. *July Hearings* app. A, at 2.

[39] House Resolution 1392, 1969 N.C. Gen. Ass'y.

[40] See note 8 *supra*.

[41] Report of the Legislative Research Commission Concerning Pesticides to the 1971 General Assembly (1970) [hereinafter cited as N.C. Pesticides Report].

[42] The commission made its recommendation of a separate agency on the theory that broad representation would inspire public confidence. N.C. Pesticides Report at 28.

[43] The committee, to be appointed by the board, would be composed of three members of the North Carolina State University School of Agriculture and Life Sciences, one farmer, one member each representing the Departments of Agriculture and Health, a natural resources agency, agri-business, the pesticide industry, a conservationist and an ecologist. *Id.* These organizational recommendations are largely the work of the Agricultural Chemicals Advisory Committee of the School of Agriculture and Life Sciences (SALS) at North Carolina State University. Recommendations to the Pesticide Study Committee of the Legislative Research Commission from SALS, May 22, 1970, at 3.

The first segment of regulatory proposals permitting the board to construct a pesticide management and control program, include provisions: a) prohibiting the use of pesticides or disposal of containers contrary to label instructions approved by the board, b) placing the burden of proof to justify safety of pesticides on the applicant for registration, c) encouraging the board to delay dates of any use restrictions to allow for phasing out of inventories, and d) authorizing the board to adopt a list of restricted use pesticides with attendant regulations concerning use and sale, other regulations to protect against misapplication, drift and related problems, and regulations to insure proper disposal of unused pesticides, containers, and other contaminated materials.[44]

A major question asked of all witnesses at the hearing was whether or not DDT or other persistent pesticides should be legislatively banned. Farmers and other agricultural interest groups were generally opposed to any absolute prohibition.[45] Witnesses from conservation and wildlife groups were equally adamant that DDT and some other pesticides be legislatively banned.[46] The commission seems to have reached a compromise.[47]

The proffered regulations do provide sufficient authority to adequately restrict dangerous pesticides, including the power to impose an absolute ban.[48] The benefit from this approach is the built-in flexibility allowing the board to adjust to current needs. However, there is no assurance that the board will take action to promulgate and enforce sufficient restrictions or that political pressures and powerful lobbies will not delay

[44] N.C. PESTICIDES REPORT at 31.

[45] *See, e.g., April Hearings* at 27 & app. D.

[46] *See, e.g., April Hearings* at 71; app. N, at 4; app. O.

[47] This compromise was endorsed by several scientists. Dr. Dan Okun, a member of the Mrak Commission and head of the Department of Environmental Sciences at UNC-CH, who advocated restricting DDT to uses essential to health or welfare, stated "[a]dministratively, it would be simple to ban the persistent pesticides, but this would deny us their uses when . . . justified . . . . An investment in regulation and control . . . would permit a selective use of such pesticides where appropriate with a minimum of associated hazards and a maximum benefit to the population." *March Hearings* app. E, at 1. See also Recommendations to the Pesticide Study Committee of the Legislative Research Commission from SALS, May 22, 1970, at 2.

[48] Many states have used regulatory powers to ban or partially ban uses of pesticides, particularly DDT. See E. Bricklemyer & M. Heath, A Detailed Review of State Pesticide Regulation and Programs 2, 4, 10, 18, 20, 22 (1970) (unpublished paper on file at Institute of Government, Chapel Hill, N.C.) and *Current Problems—Water Pollution Control in Texas, Part IV, Pesticide Pollution,* 48 TEX. L. REV. 1130, 1135 nn.38 & 39 (1970).

or prevent necessary protection. These and many other misgivings have led at least one state to initiate specific legislative guidelines.[49]

The second major group of regulatory recommendations presents a network of licensing laws for pesticide dealers and applicators and those who commercially give advice concerning pesticides.[50] This package would require licensing of dealers selling pesticides on the restricted list and registration of their employees.[51] It would provide for reporting of shipments made and volumes sold by manufacturers and would contain incidental provisions regarding record keeping, inspection and other matters needed for an effective regulatory system.[52] All types of commercial applicators and consultants—including those already covered by current law—would be licensed, but the recommendations would exempt farmers who apply pesticides to their own land.[53] Since farmers are the major users of pesticides, their omission from this licensing system might suggest a weak spot in the program. However, even if licensing of farmers were incorporated into the laws, the administrative impossibility of enforcing this provision would make the measure meaningless.[54]

Another chink in this legislative armor is that the licensing itself is insufficient to ensure that dealers are properly educated in pesticide use. Thus, the commission has submitted proposals in the field of education, research and staffing. It suggests that funds be allocated for expanded education and training for dealers, applicators, their employees, and

[49] The 1969 California legislature enacted statutes that require the Department of Agriculture to develop a program for the review of all registered economic poisons that endanger the environment, to establish criteria for the department's refusal to register or cancel a pesticide. The statutes also provide for designated reports to be rendered both by dealers and by the Director of Agriculture. E. Bricklemyer & M. Heath, A Detailed Review of State Pesticide Regulation and Programs 7 (1970).

A question arises in regard to whether North Carolina's regulatory proposals should have included legislative guidelines of this nature. This writer believes, however, that the new system should be enacted as recommended, with a watchful eye kept on the new board's activities. Guidelines should be established only when the need presents itself.

Several states have proposed absolute legislative bans on pesticides, but they have always been defeated. See, *e.g.*, *id.* at 14, 26, 41.

[50] N.C. PESTICIDES REPORT at 34.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] The expenses of additional staff necessary to license farmers would in itself be prohibitive and the impracticalities of systematically monitoring the program cannot be overcome at this time. Interview with Mr. Milton Heath, Assistant Director, Institute of Government, in Chapel Hill, N.C., on Dec. 19, 1970.

farmers.[55] North Carolina State University has requested appropriations to implement this educational program, and it is hoped that these requests will be given serious consideration.[56] The commission believes that enlarged research and monitoring programs are highly desirable, and thus recommends that the state's service monitoring activities be consolidated and that research be a function of institutions of higher learning.[57] It is essential that current research programs be continued and expanded, for the development of effective, safe and nondangerous pest control methods will be the ultimate factor in halting pesticide pollution.[58] Since the new controls will be only as effective as their implementation and enforcement, the commission further advised additional staffing to meet the needs of the new program.[59] The measures to finance these proposals call for a combination of fees raised by licensing and appropriations from the general fund totaling 400,000 dollars for the coming biennium.[60]

It is difficult to postulate the effect of the commission's recommendations on the pesticide problem in North Carolina. The suggestions have yet to be reduced to statutory form, and the statutes, when drafted, as well as the budget requests, must be approved by the 1971 general assembly. Enacted as proposed, such a comprehensive regulatory scheme will represent a step forward for the state in pesticide regulation and control. But is the step large enough? Whether the regulatory structure will be as effective at preventing harmful use of persistent pesticides as a legislative prohibition will depend largely on what regulations are made by the proposed board and how these rulings are enforced by the Department of

[55] N.C. PESTICIDES REPORT at 37.

[56] The Agricultural Extension Service, an arm of the USDA, has been attempting to develop a total education program in cooperation with North Carolina State University with pesticide co-ordinators in each county. The present need is for a dealer education program. *March Hearings* at 42-46.

[57] N.C. PESTICIDES REPORT at 37. SALS has a very active research program sponsoring some thirty programs with funds of 727,000 dollars. *March Hearings* 3-4. A segment of SALS recently has devoted much effort to the development of a pesticides monitoring system. See WATER RESOURCES RESEARCH INSTITUTE OF UNC, A WATER MONITORING SYSTEM FOR PESTICIDES IN NORTH CAROLINA (January, 1970).

[58] Dr. C.J. Nusbaum of SALS reports a vast arsenal of pest control methods available for use including population reduction by cultural practices, crop rotation, seed selection and treatment, development of resistant varieties and biological agents. *March Hearings* app. D, at 4. Dr. Nusbaum also remarked that scientists are now thinking in terms of "integrated control programs where combinations of treatments will be used rather than reliance upon a single treatment." *Id.* at 11.

[59] N.C. PESTICIDES REPORT at 38. For the Commissioner of Agriculture's estimation of minimum personnel needs, see *July Hearings* app. A, at 5.

[60] N.C. PESTICIDES REPORT at 39.

Agriculture. The great gaps in current education programs need to be filled by increased funding if the licensing proposals are to be meaningful.

> The issue of persistent pesticides is not whether the chemical revolution in the control of pests has proven useful .... [O]ur miracle innovations must be made to serve the ends of civilization .... Certainly no goal surpasses in importance the need to prevent man from harming, abusing or destroying himself and his environment.[61]

ELIZABETH LYNNE POU

Federal Estate Taxation—Life Insurance Trusts

Life insurance is often purchased by a wife on the life of her husband for the benefit of herself or her children. Should the wife predecease her insured husband, she may provide that he act either as executor of her estate or as trustee of a testamentary trust containing the insurance policies on his life and her other investment assets. Upon the insured husband's subsequent death, the Commissioner may contend that the proceeds of the insurance policies are to be included in the husband's gross estate due to the fact that at the time of his death the husband possessed incidents of ownership in the insurance policies, albeit in only a fiduciary capacity. The Court of Appeals for the Sixth Circuit dealt with such a problem in *Fruehauf v. Commissioner*,[1] in which fiduciary powers held by the insured over life insurance policies were deemed sufficient "incidents of ownership" to compel inclusion in the insured's gross estate under section 2042 of the Internal Revenue Code of 1954,[2] although he had neither owned nor made an inter vivos transfer of the policies.

Vera Fruehauf purchased six life insurance policies on the life of her husband, Harry, designated herself sole beneficiary of each policy, and paid all premiums due prior to her death. Under Vera's will, Harry was named both coexecutor of her estate and cotrustee of a trust to be formed

[61] *Persistent Pesticides* at 611.

[1] 427 F.2d 80 (6th Cir. 1970).

[2] INT. REV. CODE of 1954, § 2042, provides in part:
The value of the gross estate shall include the value of all property—

....

(2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

from her residuary estate. The will provided that "[t]o the extent possible, all life insurance policies owned by me on the life of others . . . shall be assigned to the . . . trust."[3] The net income of the trust was to be paid to Harry for life with remainder to Vera's issue *per stirpes.*

The executors and trustees were given broad powers under Vera's will,[4] including the right to surrender the insurance policies for their cash surrender value. Harry died approximately fourteen months after Vera, leaving the administration of Vera's estate incomplete. Consequently, there had been no distribution to the trust provided for in Vera's will, nor had Harry been appointed trustee by the probate court. Therefore, the assets of Vera's estate, including the insurance policies, were distributed outright to the Fruehauf's sole surviving son pursuant to Vera's will.

The executors of Harry's estate did not include the proceeds of the insurance policies in his gross estate when they filed his federal estate tax return. The Commissioner asserted a deficiency on the theory that since Harry, at the time of his death, *possessed* "incidents of ownership" in the policies as cotrustee and as coexecutor of Vera's estate, the proceeds of the policies should be included in his gross estate under section 2042. The Commissioner did not attempt to include in Harry's gross estate any of the other assets that were to comprise the corpus of the testamentary trust.

Section 2042 includes in the gross estate the proceeds of all life insurance policies on a decedent's life to the extent that "the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person."[5] Subject to one exception,[6] the Code offers no definition of the term "incidents of ownership." The Regulations, however, provide some guidance:

---

[3] Estate of Harry R. Fruehauf, 50 T.C. 915, 917 (1968).

[4] Vera's will provided in part:

Tenth: My Executors and my trustees may retain for such periods as they determine advisable any insurance policies owned by me at my death on the life of any other person, and pay the premiums on such policies whenever they become due out of income and/or principal as they shall see fit, and cause themselves to be designated as the beneficiaries thereof, or they may, at any time, sell and assign any of such policies to the person whose life is insured for the cash surrender value thereof, or they may surrender any of such policies for their cash surrender value, or they may, at any time, convert any of such policies into paid up policies in whatever amounts may be provided by the terms of such policies. With respect to any policies retained by them, they may arrange for the automatic application of dividends in reduction of premium payments and they may borrow on any of such policies, make premium payments from the funds so derived, and repay such loans.

427 F.2d at 82.

[5] INT. REV. CODE of 1954, § 2042.

[6] INT. REV. CODE of 1954, § 2042, does provide that "the term 'incidents of

> For the purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. . . .[7]

Harry's estate argued that the power Harry possessed over the policies did not constitute "incidents of ownership" within the meaning of section 2042 since these powers were held solely in a fiduciary capacity, and Harry at no time had owned or transferred the policies in an individual capacity. The Commissioner felt that both of these contentions were incorrect, and "[t]he issue was thus narrowed . . . to the question of whether the powers over the policies which decedent . . . held constitute 'incidents of ownership' in view of the fact that he held these powers in a fiduciary capacity only."[8] Both the Tax Court and the court of appeals answered in the affirmative, but for different reasons.

The Tax Court majority, relying heavily on cases arising under section 2038[9] (revocable transfers), reasoned that

> [t]here is no doubt at all but that sections 2038 and 2042 are parts of a tax pattern to make includable in the gross estate property over which the decedent held various powers affecting beneficial enjoyment. Since case law makes immaterial for purposes of section 2038 the capacity in which the powers are held, it is not logical to make capacity a significant factor as far as section 2042 is concerned.[10]

---

ownership' includes a reversionary interest . . . if the value of such reversionary interest exceeded 5 per cent of the value of the policy immediately before the death of the decedent."

[7] Treas. Reg. § 20.2042-1(c)(2) (1958).

[8] 427 F.2d at 83.

[9] INT. REV. CODE of 1954, § 2038, provides in part:

(a) . . . The value of the gross estate shall include the value of all property—

(1) . . . To the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

[10] Estate of Harry R. Fruehauf, 50 T.C. 915, 926 (1968).

The Tax Court held that "the fact the powers over the policies were held in a fiduciary capacity is no bar to their constituting incidents of ownership under section 2042."[11] The concurring judges, however, intimated that they would not go so far as to hold that "any power in the nature of an incident of ownership exercisable by an insured decedent in his fiduciary capacity causes the proceeds of the policy to be included in his gross estate."[12] They felt that the holding should be limited to its facts. That is, Harry's power as trustee enabled him to surrender the policies for their cash surrender value, which could be added to the trust corpus, thereby increasing the income producing capacity of the trust to Harry's advantage as income beneficiary.

The court of appeals disagreed with the Tax Court's approach in two respects: (1) the Tax Court's failure to recognize the different considerations underlying sections 2038 and 2042; and (2) its failure to recognize the fundamental nature of the fiduciary relationship. In discussing the first point the court of appeals declared:

> We must disagree with the Tax Court's broad *per se* rule. We believe there is a distinction between the issues arising under § 2038 where the decedent, as *transferor* of certain property, possesses at his death the power, even though in a fiduciary capacity, to revoke or change the transfer, and the issues in a case arising under § 2042 where the decedent is the *transferee*, in a fiduciary capacity, of powers constituting incidents of ownership in the insurance policies on his life. Where a decedent holds the requisite powers over policies on his life solely because he is a *transferee*, in a fiduciary capacity, of those powers, with no beneficial interest therein, such arrangement can hardly be construed as a substitute for testamentary disposition on decedent's part.[13]

As to the second point, the court criticized the Tax Court for not following previous Tax Court decisions. In *Estate of Newcomb Carlton*,[14] in which the decedent transferred twenty-one insurance policies along with certain securities to a trust, the Tax Court had held that the decedent's powers over insurance policies did *not* constitute incidents of ownership. Although the decedent retained the right to appoint a cotrustee (including himself), as well as the right to the trust income in excess of the amount needed to pay the premiums on the policies, the Tax Court concluded that

[11] *Id.*
[12] *Id.*
[13] 427 F.2d at 84 (emphasis added).
[14] 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

> [a]ny control that decedent would have acquired over the insurance policies had he appointed himself cotrustee would have been control over the policies jointly with the corporate trustee as trustee only and *such control would be solely for the benefit of the trust. Such control as trustee would not constitute incidents of ownership in the insurance policies in decedent except in his capacity as trustee for the benefit of the trust.*[15]

Similarly, the Tax Court clearly recognized the principle that fiduciary powers do not necessarily constitute incidents of ownership within the meaning of section 2042 in *Estate of Bert L. Fuchs:*[16]

> Assuming, *arguendo,* that the insured . . . possessed the naked power to change beneficiaries or make an assignment, we cannot say . . . that the insured herein should be treated in any way differently than a common trustee. Each insured herein was under no less of a legal duty to respect the terms of the partners' agreement than a common trustee legally obligated to respect the terms of a trust indenture. Decedent merely had the same type of power over the . . . policies as a trustee's power to affect trust proceeds. We do not believe that this type of naked power alone is sufficient to bring the insurance proceeds within decedent's gross estate.[17]

Based upon these two decisions, the court of appeals rejected the sweeping rule espoused by the Tax Court in *Fruehauf* by refusing to hold that "mere possession by a decedent of any powers in the nature of incidents of ownership in a fiduciary capacity invariably requires the inclusion of the proceeds of the policies on the decedent's life in his gross estate."[18] Nevertheless, the court felt that since Harry could exercise his fiduciary powers in such a manner as to benefit himself as the income beneficiary of Vera's trust, these powers, notwithstanding the fiduciary capacity in which they were held, did constitute sufficient "incidents of ownership" within the meaning of section 2042.[19]

---

[15] *Id.* at 996 (emphasis added).

[16] 47 T.C. 199 (1966). This case involved a partnership purchase agreement that prohibited decedent-owner from exercising his rights under the life insurance policy to change the beneficiary or to surrender the policy for its cash surrender value.

[17] *Id.* at 204.

[18] 427 F.2d at 85.

[19] Whereas the concurring judges in the Tax Court only emphasized Harry's power as cotrustee of Vera's testamentary trust, the court of appeals felt that either power alone (*i.e.*, cotrustee *or* coexecutor) would be sufficient to demand inclusion, reasoning that

> [u]nder the provisions of . . . decedent's wife's will, decedent was authorized, both as executor and as trustee, to surrender the policies on his life

One may criticize the *Fruehauf* opinion for its failure to examine the position of life insurance in the overall estate tax scheme. Since *Fruehauf* is the first case to hold that a decedent possesses "incidents of ownership" by virtue of his fiduciary power in life insurance policies, which he neither owned nor transferred inter vivos, one might well expect the court to set forth a detailed analysis of its reasoning. However, the court not only failed to set forth the rationale of its holding, but it also failed to take proper account of *Estate of Newcomb Carlton*,[20] which held for the taxpayer on the precise issue raised in *Fruehauf*. Although *Fruehauf* arguably overrules *Carlton* while purporting to rely upon it, it is actually a stronger case for the taxpayer than *Carlton* since the decedent in *Carlton* at one time owned the policies outright and subsequently made an inter vivos transfer to a trust, reserving the right to the net income in excess of that needed to pay the premiums and the right to appoint himself as cotrustee. Had he exercised his right to appoint himself trustee he, like Harry, could have surrendered the policies for their cash surrender value, thereby increasing the income producing ability of the trust which would inure to his benefit in exactly the same manner that prompted the court in *Fruehauf* to hold against the taxpayer. Moreover, in *Fruehauf* the fiduciary powers that the decedent possessed were not *retained* by him in connection with a lifetime transfer, as was the case in *Carlton*, but rather were *conferred* upon him by his wife's will.

Although the court sharply criticized the Tax Court for not distinguishing the basic nature of the fiduciary relationship, it apparently felt that if the trustee had a personal stake in the trust (*e.g.*, as income beneficiary) then this somehow changed the "fundamental nature of the fiduciary duty." No support for this position can be found in the Code or case law. In fact, *Carlton* stands in stark conflict with this view. Arguably, it should be of no significance whether or not the fiduciary has a personal stake in the trust. For one thing, he is still subject to control by a state court for abuse of discretion. This position was apparently adopted in *Old Colony Trust Co. v. United States*,[21] in which the first circuit seemingly

for their cash value. If this had been done the policies would have been transformed from non-income producing assets designed to benefit primarily the ultimate beneficiary of the trust into income producing assets (since it must be assumed that such proceeds would not remain idle), which would benefit decedent when he assumed his capacity as trustee and income beneficiary of the trust.

Id. at 86.

[20] 34 T.C. 988 (1960).

[21] 423 F.2d 601 (1st Cir. 1970).

rejected its earlier holding in *State Street Trust Co. v. United States*,[22] and implied that since even broad fiduciary powers are within the reach of equity courts, they do not constitute the requisite powers over the trust property that demand inclusion in a decedent's gross estate.[23]

A major deficiency in the court's opinion is its failure to deal with the estate's argument that under the Commissioner's view, insurance is treated more harshly than other assets,[24] thus being contrary to Congress' express intent to treat life insurance like other property.[25] While the full

[22] 263 F.2d 635 (1st Cir. 1959). In *State Street*, a case arising under section 2036, the court accepted the Commissioner's strict view that certain broad fiduciary powers can constitute a power to shift beneficiary enjoyment of a trust interest between life tenants and remaindermen and that these powers may be beyond the reach of a court of equity. However, it must be pointed out that in this case the fiduciary powers were retained by, not conferred upon, the decedent.

[23] Even before *Old Colony Trust* state courts had generally agreed with a Massachusetts court's criticism of *State Street* in a case holding that a trustee's broad power to shift enjoyment is subject to control by a court of equity, and such power, regardless of how broad, can only be exercised in accordance with proper fiduciary standards. Boston Safe Deposit & Trust Co. v. Stone, 348 Mass. 345, 203 N.E.2d 547 (1965). The court considered *State Street* and said that "[e]ven broadly expressed administrative and management powers . . . 'are limited by standards which the Massachusetts court of equity could and would apply to supervise effectively * * * [proper trust] administration.' We disagree with any suggestion to the contrary . . . in the majority opinion in that case. . . ." *Id.* at 351 n.8, 203 N.E.2d at 552 n.8. *See also*, United States v. Powell, 307 F.2d 821 (10th Cir. 1962); Estate of Ralph Budd, 49 T.C. 468 (1968); Estate of Marvin L. Pardee, 49 T.C. 140 (1967). Even the Commissioner, prior to *Fruehauf*, seemed to be backing away from his strict position regarding fiduciary powers. *Cf.* Rev. Rul. 69-56, 1969-1 CUM. BULL. 224.

[24] The estate's brief stated:

> Thus in 1954 Congress took great care to be sure that the same reversionary interest rule that applies to transfers made by a decedent that take effect at his death (section 2037) applied also to insurance so as "[t]o place life insurance policies in an analogous position to other property * * *." This illustrates the degree of thought that Congress gave to a redefinition of "incidents of ownership" in 1954; yet it did nothing to indicate that it intended to create a broader rule for the inclusion of life insurance proceeds than for other assets. *Nevertheless, that is precisely the result that the Tax Court reached in this case, for its holding includes the life insurance proceeds in Harry's estate but not the other assets in the same trust!*

Brief for Petitioner-Appellant at 19-20.

[25] Congress' reasons for the 1954 changes in the taxation of life insurance is set forth in the following Senate Report:

> The proceeds of life insurance on a decedent are subjected to tax in his estate under present law if the policy is payable to the executor, if the decedent paid the premiums on the policy (in this case includable in proportion to the amount paid), or if the decedent possessed any elements of ownership in the policy at date of death.
>
> No other property is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the

extent of congressional intent in this respect remains uncertain, the estate's argument should have been answered rather than completely ignored. At first glance it does seem unfair to include the total amount of the insurance proceeds in Harry's gross estate since he neither owned the policies outright nor had he transferred them during his life. In fact, Harry did not enjoy any of the tangible benefits of ownership during his lifetime other than the right, derived solely from Vera's will, to become income beneficiary of a trust comprised partially of the insurance policies as well as other assets. The fact that none of the other assets that were to be included in Vera's testamentary trust were included in Harry's gross estate, although his fiduciary powers over these noninsurance assets were just as broad as those over the insurance policies, does show that life insurance, for the first time since the 1954 Code, is being treated more harshly than other assets.

The obvious discrimination that one discerns in *Fruehauf* can be further illustrated by two hypotheticals: First, if Harry in his capacity as coexecutor immediately surrendered the policies for their cash surrender value, no inclusion would result because at his death he would not have *possessed* any incidents of ownership in the policies, but only incidents of ownership as cotrustee in noninsurance assets. However, since the property existed in the form of life insurance at the time of his death, inclusion was required. Second, suppose that instead of life insurance, the asset had been nonincome producing real property, and Harry had the power to sell and reinvest in some type of income producing asset. Here, even though the exercise of this power would benefit him as income beneficiary, there would be no inclusion[26] because the power that Harry possessed

property and to discriminate against life insurance in this respect is not justified.

The House and your committee's bill retains the present rule including life-insurance proceeds in the decedent's estate if the policy is owned by him or payable to his executor, but the premium test has been removed. To place life-insurance policies in an analogous position to other property, however, it is necessary to make the 5-percent reversionary interest rule, applicable to other property, also applicable to life insurance.

S. REP. No. 1622, 83d Cong., 2d Sess., found in 3 *U.S. Code Congressional and Administrative News* 4757 (1954).

[26] Since the fiduciary powers Harry held over Vera's testamentary trust were conferred rather than retained, no other type of asset would be included in Harry's gross estate under any of the gross estate sections for the simple reason that the estate tax is a transfer tax which requires a transfer before taxation is appropriate. C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 1.1 (2d ed. 1962) [hereinafter cited as LOWNDES & KRAMER]. The estate tax extends to those transactions in which the decedent previously

would not be retained by him in connection with a lifetime transfer, but rather would be considered as conferred upon him by Vera's will. Although the authorities differ as to whether life insurance should be treated on a par with other types of property,[27] Congress has indicated that it should be so treated. As such, the dictum in *Gorman v. United States*[28] becomes particularly instructive: since Congress intended life insurance to be treated like other property a "court [should] not legislate, nor shall the Service, in an area specifically reserved to Congress."[29]

Fruehauf portrays only one of the many estate tax pitfalls awaiting the unwary estate planner faced with life insurance. Primarily, these problems arise because at no time during the history of the estate tax has Congress, the Treasury, or the courts set forth a workable definition of "incidents of ownershp." Congress should meet this challenge and carefully define the scope of "incidents of ownership" as well as the position of life insurance in the overall scheme of estate taxation.[30] Until this can be done, however, estate planners should avoid placing the surviving spouse

owned and transferred property during his lifetime but *retained* some interest, power, or right over the property. The estate taxation of such transactions is justified on the basis that they are mere substitutes for testamentary dispositions of property. The sole exception to these general statements is the specific section of the Code that deals with the situation in which a decedent possessed powers that were conferred upon him by another person—section 2041. Arguably, this section is not applicable to the *Fruehauf* facts. Section 2041 taxes general powers of appointment and thus permits inclusion in the gross estate of property never owned nor transferred by the decedent. In effect, this section represents congressional recogniton of general powers of appointment as *substantial* incidents of ownership since the holder of the power can freely dispose of property that he does not own according to his own desires. Since the language of section 2042 seems, on its face, to be more analogous to the language of section 2041 dealing with *conferred* powers (*i.e.*, section 2042 does not expressly require that the decedent own or transfer the policy, but only that he possess at his death any of the incidents of ownership), the Commissioner has interpreted section 2042 literally, and has taken the position that if the decedent dies with any of the requisite incidents of ownership over the policies, then the entire face value is to be included in his gross estate regardless of whether he possessed these incidents of ownership as a "string" *retained* by him as a result of an incomplete transfer, or simply as a result of having them *conferred* upon him in a fiduciary capacity.

[27] Many writers disagree with Congress' position that life insurance should be treated like any other type property. *E.g.*, LOWNDES & KRAMER § 13.4; Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DE PAUL L. REV. 48 (1965). However, Congress' position has been supported by others. *E.g.*, Swihart, *Federal Taxation of Life Insurance Wealth*, 37 IND. L.J. 167 (1962).

[28] 288 F. Supp. 225 (E.D. Mich. 1968).

[29] *Id.* at 230.

[30] This has been suggested previously in Note, *Taxation—Federal Estate Tax—Cotrusteeship Sufficient Incidents of Ownership To Require Inclusion of Corpus in Cotrustee's Gross Estate Where Possibility of Economic Benefit Exists*, 22 VAND. L. REV. 711 (1969).

in a position whereby he has any powers over insurance polices on his life capable of being exercised for his own benefit. Thus, in order to avoid the *Fruehauf* tax trap the estate planner must provide for two trusts—one containing only the insurance policies, over which the surviving spouse should have no powers in the nature of "incidents of ownership;"[81] the other containing noninsurance assets, over which the surviving spouse may safely act as trustee. Additionally, *Fruehauf* indicates that should the surviving spouse act as executor, he must be expressly prohibited from exercising any powers in the nature of "incidents of ownership" over insurance policies on his life owned by his spouse, if these policies are to ultimately become a part of a *Fruehauf* trust. Until this area is resolved, this is the only safe course of estate planning to take when faced with life insurance trusts.

THOMAS R. CRAWFORD

Federal Estate Taxation—Revenue Ruling 67-463 Has Been Dealt A Grave Injustice

As the smoke clears from the aftermath of the decision of *First National Bank (of Midland) v. United States*,[1] we find that the Commissioner of the Internal Revenue Service has once again met defeat. The score now stands: taxpayers, three, the Commissioner and Revenue Ruling 67-463, zero.[2] Completely realizing the possible adverse consequences to taxpayers and estate tax planners, it will be shown, nevertheless, that the Commissioner has been dealt a grave injustice.

Several years ago the Commissioner decided to review the estate tax consequences of gifts of life insurance in situations where the deceased-insured paid part of the premiums in contemplation of death, but had given away all incidents of ownership in the policy more than three years prior to death.[3] To determine the amount to be included in the decedent's gross estate the Commissioner issued Revenue Ruling 67-463:

[81] In fact, the surviving spouse should never be designated as trustee over the insurance trust since many states have provisions providing that a trustee has certain broad powers, such as the power to sell, even though not specifically granted by the trust instrument.

[1] 423 F.2d 1286 (5th Cir. 1970).

[2] Rev. Rul. 67-463, 1967-2 CUM. BULL. 327.

[3] For example, decedent took out a fifty thousand dollar face amount policy on his life six years before death. He paid all six thousand dollars of the premiums (one thousand dollars annually), with one-half (three thousand dollars) of the

A decedent, within three years of death and in contemplation of death, paid the premiums on a policy of insurance on his life. He had transferred the incidents of ownership in the policy to his wife more than three years prior to his death. *Held*, such payment was a transfer of an interest in the policy measured by the proportion the amount of premiums so paid bears to the amount of premiums paid. Accordingly, the value of the proportionate part of the amount receivable as insurance that is attributable to those premiums paid by the decedent within three years of death is includable in his gross estate under section 2035 of the Internal Revenue Code of 1954. This conclusion is also applicable where the wife originally applied for the insurance.[4]

The Commissioner's first setback with regard to Revenue Ruling 67-463 came in 1968 in *Gorman v. United States*,[5] in which the life insurance company issued a policy on the decedent's life that designated his wife as beneficiary and owner of all rights and privileges.[6] In procuring the insurance, the insured had requested that the policy be so written. The policy was issued, and the insured paid the first and, as it turned out, the only premium. Less than one year later the decedent-insured died. The district director of the Internal Revenue Service sought to include the proceeds of the policy in decedent's gross estate,[7] arguing that the decedent's procurement of the policy or his payment of the premiums amounted to a gift in contemplation of death within the meaning of section 2035 of the Internal Revenue Code.[8] Plaintiff, decedent's wife and

premiums being paid within three years of his death. When he took out the policy initially, he immediately transferred all the incidents of ownership to the beneficiaries. It is conceded that the last three premium payments were made in contemplation of death.

[4] Rev. Rul. 67-463. Under this revenue ruling, in the example set forth in note 3 *supra*, the inclusion would be twenty-five thousand dollars because one-half of the premims were paid in contemplation, and one-half of the face amount equals twenty-five thousand dollars. Under the ruling the same result would be reached even if the beneficiaries or donees originally applied for the policy on the life of the decedent.

[5] 288 F. Supp. 225 (E.D. Mich. 1968).

[6] *Id.* at 236.

[7] *Id.* at 234-35.

[8] INT. REV. CODE of 1954, § 2035, states:

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

(b) APPLICATION OF GENERAL RULE.—If the decedent within a period of 3 years ending with the date of his death (except in case of a bona fide sale for an adequate and full consideration in money or money's worth) transferred an interest

executrix under his will, paid the tax and sued for refund. The district court held that the premium was paid in contemplation of death but that the amount to be included in the decedent's gross estate was only the actual cash premium paid and not the pro rata amount of the proceeds.[9]

In December of 1968, the Commissoner temporarily found reason to rejoice. In *First National Bank (of Midland) v. United States*,[10] also a refund suit, the United States District Court upheld Revenue Ruling 67-463.[11] In this case the decedent and his wife purchased two life insurance policies on decedent's life, one for each of their daughters. The daughters were named as the owners of the policy and held all the incidents of ownership in their respective policies. The premium payments, including three in contemplation of death,[12] were made with community property funds. A portion of the proceeds of the two policies were included in the decedent's gross estate under section 2035. The court did not discuss prior case law or legislative history but merely cited Revenue Ruling 67-463 as the basis for its decision.[13] The Commissioner's apparent victory was swept aside when the fifth circuit reversed the district court on March 23, 1970.[14] The court of appeals relied on the *Gorman* case and *Estate of Coleman*[15] discussed below.

The Tax Court was faced with this issue for the first time in 1969. A full court review dealt the Commissioner another defeat. In *Coleman* the decedent's three children purchased, as record owners and beneficiaries, an insurance policy on the decedent's life. The decedent had paid all the premiums, and it was admitted that several premiums were paid in contemplation of death. The government contended that the amount to be included in the gross estate was "that part of the total proceeds which bears

in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable transfers and powers of appointment); but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death.

The purpose of section 2035 is to reach substitutes for testamentary dispositions and thus prevent evasion of the estate tax.

[9] 288 F. Supp. at 234.

[10] 69-1 U.S. Tax. Cas. ¶ 12,574 (W.D. Tex. Dec. 11, 1968).

[11] *Id.* ¶ 12,574, at 84,831.

[12] *Id.* The plaintiffs made no effort to disavow the presumption that the premiums were made in contemplation of death.

[13] *Id.*

[14] 423 F.2d 1286 (5th Cir. 1970).

[15] 52 T.C. 921 (1969).

the same proportion to the total proceeds as the premiums paid in contemplation of death bear to the total premiums paid."[16] The court held that the amount includable in the gross estate was limited to the premiums paid in contemplation of death.[17]

Even though the Commissioner has lost three cases, he has not and probably will not concede defeat at the moment because the opinions in the three decided cases have been far from convincing and well-reasoned. In *Gorman* the court began its attack on the Commissioner's position by relating the legislative history of section 2042.[18] The court reasoned that the deletion of the "premium payment test" in section 2042 indicated a congressional intent to prohibit any inclusion of policy proceeds in an insured's estate based on the insured's payment of premiums.[19] The court decided that to allow the IRS to use a premium-based test to include part of the proceeds of life insurance—even in valuing a transfer in contemplation of death under section 2035—would effectively defeat the congressional policy evidenced by the changes in section 2042.[20] The court felt that Revenue Ruling 67-463 was an administrative attempt to adopt in part the premium payment test, which was deleted from the revenue laws by the enactment of the 1954 Code.[21]

In so reasoning the court seems to have adopted an unnecessarily broad interpretation of the 1954 changes. Congress rejected the "payment of premiums" test as too harsh a basis for inclusion of insurance proceeds in the taxable estate under section 2042 but gave no indication that it intended to make payments of premiums irrelevant to taxation under other sections of the federal estate tax.[22] The majority of the House Ways and Means Committee indicated that "payment of premiums is no longer a factor in determining the tax liability *under this section* (section 2042) of insurance proceeds."[23] Thus the court failed to distinguish between "payment of premiums" as an independent basis for inclusion under section 2042, a basis that had been deleted from the Code in 1954, and the payment of a premium as a transfer made in contemplation of death

[16] *Id.* at 922. The government relied on Rev. Rul. 67-463.
[17] *Id.* at 924.
[18] 288 F. Supp. at 227-28. *See* INT. REV. CODE of 1954, § 2042. This section deals with the rules governing the includibility of proceeds of life insurance when the insured retains "incidents of ownership."
[19] 288 F. Supp. at 227-28.
[20] *Id.*
[21] *Id.* at 227.
[22] *See* H.R. REP. No. 1337, 83d Cong., 2d Sess. A316-17 (1954).
[23] *Id.* at A316 (emphasis added).

under section 2035.[24] It must be re-emphasized that in *Gorman*, as well as in *First National Bank (of Midland)* and *Coleman*, the courts were concerned only with a section 2035 inclusion and not with a section 2042.[25]

The next problem in the *Gorman* decision concerns the court's view as to what constitutes a "transfer" under section 2035.[26] The court stated that

> [t]he specific interpretative issue is what is the value of the property transferred by the decedent . . . when he pays in contemplation of death directly or indirectly premiums on a life insurance policy.[27]

The court decided that once it has been determined that an interest in property has been transferred in contemplation of death, the amount included in decedent's gross estate is the value of the interest transferred as of the applicable valuation date.[28] The court stated that "our focus must at all times be directed to what was in fact transferred by the decedent when he paid a premium in contemplation of death."[29] The court then relied on the "specific asset theory"[30] and decided that if anything were to be included in the gross estate, "it should be limited to the value of the asset transferred, namely the premium."[31] Thus the court in *Gorman* failed to come to grips with the issue to what constitutes a "transfer."

The government asserted that the procurement of the insurance policy by the decedent for his wife was a "transfer" of the policy within the meaning of section 2035[32] and that the total proceeds from the policy, as a result of payment of the premium, is includable in the estate of the decedent. The government cites *Chase National Bank v. United States*[33]

[24] The government argued that the conclusion reached by the ruling is actually consistent with the intent of Congress in dropping the premium payment test from the code because it places life insurance on an equal footing with other property.

[25] *See* INT. REV. CODE of 1954, § 2042; Treas. Reg. § 20-2042 (1954).

[26] 288 F. Supp. at 228.

[27] *Id.*

[28] *Id. See* Treas. Reg. § 20-2035-1(e), T.D. 6501.

[29] 288 F. Supp. at 230-31. The court's discussion fails to shed light on the problem.

[30] *Id.* at 233.

[31] *Id.*

[32] *Id.* at 226.

[33] 278 U.S. 327 (1929). The decedent purchased three policies payable to his wife as beneficiary. He reserved the right to change the beneficiary and to surrender the policies. After his death, his executor contended that there was no transfer because the proceeds did not come directly from the decedent but instead came from the insurer. The Supreme Court refused to accept this distinction and reasoned that because of his retained rights, the decedent until his death retained a legal interest in the policy, which effectively gave him a power of disposition over the proceeds. The Court concluded that the termination of such power was

in support of its view. The government contended that even though ownership in the policy was created in the wife, the transaction itself was really a transfer by the decedent of those rights since he was the one who provided the consideration or motivating force for the transaction. The insured was the master of his offer and the transferor of the policy when he made application to the insurance company and decided to have the company's "bargained for promise" run to his wife.[34] This position is appealing since the law should not distinguish between the situation where *A* pays *B* to give something to *C* and the situation where *A* purchases the thing and makes a gift of it to *C*.[35] The court in *Gorman*, however, dismissed the argument by noting that the Supreme Court in *Chase* never considered the relationship of premiums to proceeds.[36] In so doing, the court simply avoided the fact that the procurement of the policy itself may have been a transfer in contemplation of death. Inclusion of a gift under section 2035 should not be affected by the fact that, at the time of the transfer, the decedent immediately and absolutely parted with the enjoyment of or title to the property.[37] As stated in *United States v. Wells*:[38]

---

a constitutionally taxable transfer and need not have been preceded directly by a transfer from the decedent to the recipient of his bounty. It thought the word "transfer" should not be restricted to direct transfers, but should "at least include the transfer of property procured through expenditures by the decedent with purpose, effected at his death, of having it pass to another." *Id.* at 337.

[34] *See* Simmons, *District Court invalidates IRS' three-year premium payment rule*, 29 J. TAX. 338, 339 (1968).

[35] *See generally* Note, *Inclusion of Insurance Proceeds Because of the Decedent's Continuous Premium Payment—The Continued Validity of Revenue Ruling 67-463*, 64 NW. U.L. REV. 116 (1969). Under section 2035 if *A* transfers one hundred dollars in cash to *B* in contemplation of death only one hundred dollars will be included in *A*'s gross estate. However, if *A* transfers a piece of real property in contemplation with a fair market value of one hundred dollars, and when *A* dies the property has a fair market value (FMV) of one thousand dollars, one thousand dollars is included in *A*'s gross estate. What if *A*, in contemplation of death, gives *X* one hundred dollars and tells him to buy a *certain* piece of real property and give it to *B*. If this piece of property has FMV of one thousand dollars when *A* dies, surely no one would doubt that the amount to be included should be one thousand dollars. This same type of analysis should be applied in the life insurance situation being discussed. *See* 1967-2 CUM. BULL. 327, 328, which states that:

> [A] premium payment under a contract of life insurance by other than the owner of the policy is analogous to a gift of specific property by the donor to the owner. Unlike the unrestricted gift of money a premium payment is a gift of insurance protection, a transfer of an interest in the policy which is transmuted at death into the proceeds of the policy.

[36] 288 F. Supp. at 228.

[37] Treas. Reg. § 20.2035-1(a), T.D. 6501.

[38] 283 U.S. 102 (1931).

> [t]he quality which brings the transfer within the statute is indicated by the context and manifest purpose. Transfers in contemplation of death are included within the same category . . . with transfers intended to take effect at or after the death of the transferor. The dominant purpose is to reach substitutes for testamentary dispositions and thus to prevent evasion of the estate tax.[39]

Thus, the *Chase* notion is that the decedent need not transmit property directly to the recipient to be viewed as the "transferor" within the meaning of section 2035. The actions of the insured in *Gorman* could well be viewed as equivalent to a "transfer" of the policy. Certainly, the transaction in *Gorman* is not functionally distinguishable from a situation where the policy was originally issued in the decedent's own name and then transferred to the wife immediately.[40] It should be remembered that while the insurer created the policy rights solely in the decedent's wife, it did so only at decedent's request and because of the consideration supplied by him.

Furthermore, the court in *Gorman* did not adequately consider whether, by paying the premiums, the decedent made a transfer of a pro rata share of the proceeds to his wife. To advance this view, the government relied on *Liebmann v. Hassett.*[41] The court, however, distinguished *Liebmann* (and thereby evaded the issue) by saying:

> *Liebmann* . . . is not authority for the proposition that payment of premiums transfer an interest in an insurance policy in the absence of a provision such as section 302(g) . . . As clearly indicated . . . the court relied on section 302(g) . . . to equate the payment of premiums by the decedent's wife to an addition or improvement made by her to the

[39] *Id.* at 116-17.

[40] *See* Note, *Inheritance and Estate Taxes—Insurance Policies—Premiums Paid in Contemplation of Death Held Taxable to the Estate of the Insured Only to the Extent of the Amount Paid,* 82 HARV. L. REV. 1765, 1767 (1969); Note, *Federal Taxation—Section 2035, Internal Revenue Code of 1954—Life Insurance Proceeds —Revenue Rule 67-463,* 43 TUL. L. REV. 882, 892-93 (1969).

[41] 148 F.2d 247 (1st Cir. 1945). The decedent transferred a life insurance policy to his wife in December, 1935, and died in October, 1937. After the transfer, the wife paid the two annual premiums. The wife stipulated that the policy was transferred in contemplation of death. The court decided that the interest transferred was to be valued at the date of death. To determine the value, the court turned to section 302g (INT. REV. CODE of 1926, § 302(g)) which made life insurance payable to the named beneficiary includible to the extent that it was "taken out" by the decedent. The court excluded that part of the proceeds which were "purchased" by the last two premiums paid by the wife.

property transferred in an amount equal to a pro rata amount of the proceeds.[42]

Thus, the court in *Gorman* concluded that it was only the existence of section 302(g) that resulted in its conclusion that there was a transfer of a pro rata share of the proceeds.[43] Since the court found no necessary relationship between the payment of premiums and the proceeds of the policy, it was unable to see how the decedent could be characterized as the motivating force behind the proceeds payment. The court concluded that any and all rights to the proceeds came from the contract with the insured, not from the payment of premiums.[44] The court has failed to look through form to substance.

In essence, the court in *Gorman* held that the payment of premiums by a nonowner of a policy was not in any sense a transfer of an interest in the policy or any of the contractual rights of that policy. Since in the court's view only a transfer of these contractual rights would dictate the inclusion of the proceeds of the policy in the gross estate, only the amount of the premium was so included. "This analysis has the apparent virtue of turning upon a transfer that was actually made: the husband's payment of the premium."[45] However, the court's analysis would seem to be correct only if the premium payment were to be valued at the time of transfer rather than at the insured's death. With the exception of cash transfers,[46] property transferred in contemplation of death is valued as of the date of the transferor's death and not at the time of the transfer.[47] Since other transfers, such as those of stocks and real property, are valued in the taxable estate at the time of the donor's death, consistency dictates that insurance be similarly treated.[48]

As indicated, the problem is how to value a premium when the valuation is made at the time of the insured's death and the beneficiary has become entitled to the proceeds of the policy. The valuation favored by the court in *Gorman* is incorrect. The premiums are the consideration furnished for the insurance company's promise to pay the proceeds at the donor's death. When the donor pays the premium, he is not merely giving the

[42] 288 F. Supp. at 229-30. *Cf.* Treas. Reg. § 20.2035-1(e), T.D. 6501.
[43] 288 F. Supp. at 229-30.
[44] *Id.*
[45] Note, 82 HARV. L. REV., *supra* note 40, at 1768.
[46] *Cf.* Humphrey's Estate v. Commissioner, 162 F.2d 1 (5th Cir. 1947).
[47] *See* Treas. Reg. § 20.2035-1(e), T.D. 6501.
[48] See generally Note, 82 HARV. L. REV., *supra* note 40.

amount of the premium; his purpose is to insure that the contractual benefits will be received by the beneficiary. Revenue Ruling 67-463 more clearly reflects the values that were actually transferred. This ruling does not re-establish the old payment of premiums inclusion as only the values transferred in the three years preceding the insured's death can be included in the estate under section 2035. Thus, if the insured had paid no premium and had no interest within the three years, none of the proceeds of the policy could be included in the taxable estate.

The court of appeals in *First National Bank (of Midland)* failed to shed any light on the controversy, and simply relied on *Gorman* and *Coleman* to reach its decision. The court stated that "[w]e are not dealing with a case in which the policy itself was transferred."[49] As pointed out earlier and re-emphasized in the discussion below in *Coleman*, this is a dubious distinction.[50] The court rejected the government's claim that payment of life insurance premiums by decedent on policies owned by his daughters, transferred "insurance benefits" to them for federal estate tax purposes. The government acknowledged that the value of the decedent's payments *at the time they were made* was their dollar value; however, the government explained that the "property or interest in property" actually transferred to the daughters through the agency of the insurance company, was not the cash amount of premium payments, but a "bundle of rights" under the insurance contract. The government concluded that the decedent made a transfer of rights in the same way that a purchaser of real property in the daughters' names would transfer the property to them rather than the consideration paid for it.[51] The daughters therefore received insurance benefits, not cash, and the payment of the premiums produced the proceeds. The court, relying on *Gorman* and *Coleman*, rejected the government's argument.[52] The government's argument in *Gorman* and *Coleman* are equally applicable to the *First National Bank (of Midland)* decision.

The majority opinion in *Coleman* displays on its face the weaknesses of its arguments. The court stated:

> Section 2035, by its terms, applies only to a "transfer" of an interest in property by a decedent. In Rev. Rul. 67-463, 1967-2 C.B. 327,

[49] 423 F.2d at 1287.
[50] See examples in note 35 *supra*.
[51] 423 F.2d at 1287-88.
[52] *Id.* at 1288.

> respondent decreed that the mere payment of premiums operated as a transfer of an interest in the proceeds of insurance—in this case, by the decedent to the children. We disagree.
>
> If the decedent had purchased a life insurance policy, initially retaining the ownership in herself, and thereafter assigned it to her children, there clearly would have been a "transfer" of an interest in the policy.[53]

In essence the majority holds that if the insured takes out an insurance policy on his own life, then transfers it to the beneficiary and continues to pay all the premiums, this is a transfer. But, if the beneficiary/owner takes out the policy initially on the insured (as in *Coleman*), even though the insured procures the policy—negotiates for the policy, takes the medical exams, pays the premium— this is a different situation and therefore not a transfer. The court makes one factual element— who first took out the policy—the crucial factor as to whether there is a transfer.[54] Obviously, the majority does not come to grips with the Commissioner's argument for inclusion of a proportionate part of the proceeds. Instead, the majority makes matters hinge upon pure formalism, a matter of no meaningful substance to wit: Did decedent, after taking the medical exam and paying the first premium, have the policy run to her and then at once transfer it to her children; or, did decedent, after taking the medical exam and paying the first premium, have the insurance agent draw the policy with it running directly to her children? Surely, there should be no substantive difference in the two situations.

In *Chase*, relied on by the Commissioner, the court gave the proper interpretation and scope to the term "transfer."

> Obviously, the word "transfer" in the statute, or the privilege which may constitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, *effected at his death*, of having it pass to another. Sec. 402(c) taxes transfers made in contemplation of death. It would not, we assume, be seriously argued that its provisions could be evaded by the purchase by a decedent from a third person of property, a savings bank book for example, and its delivery by the seller directly to the

[53] 52 T.C. at 923.
[54] *Id.* at 927-28 (Raum, J., dissenting).

> intended beneficiary on the purchaser's death, or *that the measure of the tax would be the cost and not the value or proceeds at the time of death.*[55]

The majority in *Coleman* chose not to follow the substantive approach of the Court in *Chase* and applied a formal, restrictive definition of transfer, however, there were three well-reasoned dissents.[56] One of the dissenters relied on the above quoted passage from *Chase* and then neatly turned the majority's narrow formalism back upon it.[57] He did this by pointing out how strange it is to include only the amount of cash expended in contemplation of death because that cash was never transferred as such to the children. If "transfer," as the majority indicated, means that a particular form of property must leave the decedent and arrive in that same form in the hands of the beneficiary, then there was no more a "transfer" of the cash than there was of the insurance proceeds.[58] This same dissenter stated:

> The real question is how to value that transfer. I think it should be valued at what the amounts paid as premiums purchased in the way of insurance protection and not at what was actually paid for that protection.[59]

Another dissenter summed up the failure of the majority viewpoint:

> It seems to me that the majority opinion fans the flickering flame of form. The legal and economic substance is indeed interred. Too much emphasis is placed on formalities. Certainly the decedent had an "interest" in the insurance policy on her life. Granted that her children were "the record owners and beneficiaries," it was the decedent who *actually purchased* the policy.[60]

There are several other considerations that must be pointed out concerning Revenue Ruling 67-463. It should be emphasized that none of the cited cases has provided an answer to the valuation problem where the decedent initially took ownership of the policy and then transferred all ownership to beneficiaries more than three years before death, but con-

[55] 278 U.S. at 337 (emphasis added).
[56] 52 T.C. 926-28 (dissenting opinions).
[57] *Id.* at 926-27 (Tietjens, J., dissenting).
[58] *Id.*
[59] *Id.* at 926.
[60] *Id.* at 928 (Dawson, J., dissenting).

tinued to pay the premiums. The cases went no further than recognizing that this was a transfer. Revenue Ruling 67-463 does provide an answer. Therefore, estate planners should be aware that the ruling in this respect has not been rejected and should be considered when planning estates.[61]

In addition to the strong arguments supporting the Commissioner's view, there is one additional consideration that would dictate the adoption of Revenue Ruling 67-463. If this ruling is not accepted certain inequalities will actually ensue. Consider the man who cannot obtain life insurance because of age or medical history. He cannot benefit from the *Coleman* rule. For example, if he desires to give real property to his family as a source of income after he dies, and he does so in contemplation of death, the value of the property at his death would be included in his gross estate. If the property has increased in value, his estate tax burden will also be increased. Under the *Coleman* situation, the man who is insurable has a definite advantage. He can acquire an insurance policy with the beneficiaries as initial owners, guaranteeing the payment of proceeds far greater than his paid-in premiums, and will suffer an estate tax inclusion of only the amount of the actual cash premiums paid in contemplation of death. Therefore, for the same dollar outlay and the same ultimate values transferred, the insurable transferor will be able to transfer to his family an increased amount of values by virtue of the lower estate tax cost. Unless the revenue ruling is accepted, insurance will not be on the same footing as all other property. Indeed, values passing by insurance will receive more favorable tax treatment than all other forms of property transmitted at death.

The decisions thus far on Revenue Ruling 67-463 amass a "mixed-bag" of reasoning and create artificial distinctions. Realizing this, the Commissioner is unlikely to give up. As a federal tax system must deal in economic realties, the word "transferor" should be read to include those persons who provide the consideration for a transfer. As one authority has noted:

[61] For estate tax planners, it should be noted that the commissioner is still free to insist upon the larger inclusion as set out in the ruling although he has lost the three mentioned cases. As far as we here in the fourth circuit are concerned, we must cope with the ruling until such time as this circuit has a court of appeals decision on the matter. While it is true that the Revenue Act of 1969 made the Tax Court a constitutional court, this does not mean that the Tax Court is bound in all later cases by the decision of a single circuit court of appeals. Instead, the present state of affairs is that the Tax Court is bound in later cases only by court of appeals decisions involving cases in that particular circuit. Jack E. Golson, 54 T.C. 742 (1970).

> It seems reasonably clear that, if I direct my broker to purchase 100 shares of xyz stock in the name of my son and I pay the purchase price, I have transferred 100 shares of xyz stock, not the dollars paid.[62]

If a decedent seeks out the insurer, negotiates all the terms of the policy, requests the insurer to create all the policy rights in another, and pays the first premium which actually brings the contractual rights, as evidenced by the policy issued, into existence, to say that this is not a "transfer" by the decedent is to put form over substance. If the decedent continues to pay the premiums, he remains the motivating force of the transaction, at least with respect to the amount of proceeds attributable to the premium payments within three years of his death. The premium was paid to the insurer to purchase an asset—the asset being the insurer's promise to pay the policy proceeds on the death of the insured. Inherent in life insurance is the fact that the value of the company's promise to pay is always increasing in value as death draws nearer. The decedent's payment to the insurer is prompted by the knowledge that this manner of payment will assure him of getting something more for his money, *i.e.*, a benefit to the donee greater than the dollars paid for the premium payment, in the form of insurance proceeds in excess of the money paid.

> On balance, the pro rata valuation (the Revenue Ruling's procedure for valuation) seems to be the method which best carries out the prior policies and decisions regarding the taxation of gifts in contemplation of death. It takes cognizance of the donor's intent in paying the premiums and does not violate the congressional intent that underlays the amendments to section 2042.[63]

MICHAEL DONWELL GUNTER

Insurance—Life Insurance Applications: Opinion Answers or Material Misrepresentations

With its recent decision in *Prudential Insurance Co. of America v. Barden*,[1] the Court of Appeals for the Fourth Circuit may have demonstrated that the converse of the time-worn judicial apology, "hard cases make bad law," is not necessarily true. Beneath *Barden's* deceptively

[62] Stephens, *The Clifford Shadow over the Federal Estate Tax*, 4 GA. L. REV. 233, 248 (1970).

[63] *See* Note, 82 HARV. L. REV., *supra* note 40, at 1771.

[1] 424 F.2d 1006 (4th Cir. 1970).

simple exterior, one finds a questionable application of an established insurance law doctrine that is worthy of close scrutiny.

On September 29, 1966, Frank Barden, forty-eight years old and an accountant by profession, applied for two policies on his life, each in the amount of ten thousand dollars. His written application under a group plan for the American Institute of Certified Public Accountants avowed the completeness and truth of its contents, among which were the following questions and Barden's corresponding answers:

10. Has the Person Proposed for Insurance ever been treated for or had any indication of:	Yes	No
. . .		
(d) Stomach or Intestinal Trouble?	(X)	( )

11. Has the Person Proposed for Insurance within the past 5 years:	Yes	No
(a) Had or been advised to have a surgical operation?	(X)	( )
(b) Been a patient in or advised to enter a hospital or sanitorium?	(X)	( )
(c) Consulted, been attended or examined by a doctor or other practitioner?	(X)	( )

12. Has the Person Proposed for Insurance any physical deformities, impairments or ill health not recorded in answer to Question 10 or 11?	Yes	No
	( )	(X)

13. What are the complete details of all "Yes" answers to Questions 10, 11 and 12?

Question No.	Condition, Details and Number of Attacks (if operated, so state)	Duration of Disability	Complete Recovery	
			Month	Year
10(d)	Appendicitis Operation	5 days	May	1964

Names and Addresses of Physicians and Hospitals
Dr. O.E. Bell Memorial Hospital Rocky Mount, N.C.[2]

[2] *Id.* at 1007.

With the exception of the disclosed appendectomy, Barden omitted all mention of his lengthy medical history which included diagnoses of a ruptured blood vessel in the stomach or esophagus, cirrhosis of the liver, and acute alcoholism.[3] The policies were issued on October 1 and remained in force until the insured's death from acute pancreatitis three months later.

In the insurer's subsequent suit to rescind the policies because of alleged material misrepresentations, the trial court granted its motion for summary judgment and concluded that "in fact and in law the answers to questions 12 and 13 . . . were clearly false, with no waiver or estoppel on the part of . . . [the company]; that said answers were material as a matter of law. . . ."[4] On appeal, with the evidential facts not in dispute, the Court of Appeals for the Fourth Circuit reversed, finding that the insurance company had failed to prove a misrepresentation and in any event, the company by issuing the life insurance policy waived any claim it had of material misrepresentation.[5]

Section 58-30 of the North Carolina General Statutes provides:

> All statements or descriptions in any application for a policy of insurance, or in the policy itself, shall be deemed representations and not warranties, and a representation, unless material or fraudulent, will not prevent a recovery on the policy.[6]

The purpose of this statute is to prevent the insurer from avoiding payment of honest losses upon technicalities and strict construction of the insurance contract.[7] Its use of the disjunctive, "or," is singularly im-

[3] Within one year after the disclosed appendicitis operation, Barden was readmitted to the same hospital on complaint of nausea and vomiting of blood. Following two injections of whole blood and glucose, he remained there for over a week pending a final diagnosis of a ruptured blood vessel in the stomach or esophagus. Gall bladder difficulty had been suspected, but tests for the disorder proved negative. On January 17, 1966, he consulted a different physician (Dr. Weeks) from the one who had attended him in the past (Dr. Bell) in order to receive a general check-up because of excessive fatigue. Dr. Weeks' examination resulted in a diagnosis of acute alcoholism with directions to remain on a special diet and abstain completely from alcoholic indulgence. Three months later (and only five months prior to his application for insurance), Barden was admitted to Rocky Mount Sanitarium Hospital due to abdominal pain, nausea and frequent regurgitation of food. After a six day convalescence, he was released—this time with a diagnosis of cirrhosis of the liver. From this date until the time of his death he continued periodically to consult Dr. Weeks, who, though noting some improvement in Barden's condition, kept his original directions in force. *Id.* at 1008-12.

[4] *Id.* at 1007.

[5] *Id.* at 1006.

[6] N.C. GEN. STAT. § 58-30 (1965).

[7] Garvey v. Old Colony Ins. Co., 153 F. Supp. 755, 757 (E.D.N.C. 1957); Cot-

portant to the insurer, for it obviates the necessity of proving knowledge or intent in a suit to rescind the policy because of a misrepresentation of a material fact.[8] In North Carolina the issue of materiality is resolved by the application of what has been termed the "individual insurer" rule:[9] If the knowledge or ignorance of the disputed fact would naturally influence the judgment of the insurer in accepting the risk or in fixing the rate of the premium, then that fact is deemed to be material.[10] Ordinarily, the resolution of this question is for the jury,[11] but like many general rules, this, too, is subject to exception. In an application for a policy of life insurance, it is established law in North Carolina that written questions relating to health, and written answers thereto, are considered material as a matter of law.[12] In such cases, the only relevant inquiries for the jury are whether the insured made the statement and if so, whether it was false.[13]

In ruling upon the effect of the insured's answer to question 12, the court neatly avoided the issue of materiality by treating the inquiry as if it called only for an opinion. Basing its decision upon the physician's optimistic reports of the preceding May and August,[14] the court concluded that these reports

---

tingham v. Maryland Motor Car Ins. Co., 168 N.C. 259, 261, 84 S.E. 274, 275 (1915).

[8] *See* Walker v. Philadelphia Life Ins. Co., 127 F. Supp. 26, 29 (E.D.N.C. 1954); Tolbert v. Mutual Benefit Life Ins. Co., 236 N.C. 416, 418, 72 S.E.2d 915, 917 (1952); Inman v. The Sovereign Camp of the Woodmen of the World, 211 N.C. 179, 181, 189 S.E. 496, 497 (1937).

[9] Note, *Insurance: Concealment and Misrepresentation as Grounds to Avoid Policy*, 5 U.C.L.A.L. REV. 332, 334 & n.15 (1958).

[10] *E.g.*, Garvey v. Old Colony Ins. Co., 153 F. Supp. 755, 757 (E.D.N.C. 1957); Tolbert v. Mutual Benefit Life Ins. Co., 236 N.C. 416, 418-19, 72 S.E.2d 915, 917 (1952); Wells v. Jefferson Standard Life Ins. Co., 211 N.C. 427, 429, 190 S.E. 744, 745 (1937); Gardner v. North State Mut. Life Ins. Co., 163 N.C. 367, 374, 79 S.E. 806, 809 (1913).

[11] *E.g.*, Senandoah Life Ins. Co. v. Hawes, 256 F. Supp. 366, 367 (E.D.N.C. 1966); Carroll v. Carolina Cas. Ins. Co., 227 N.C. 456, 458, 42 S.E.2d 607, 608 (1947); Howell v. American Nat'l Ins. Co., 189 N.C. 212, 217, 126 S.E. 603, 605-06 (1925).

[12] *E.g.*, Shenandoah Life Ins. Co. v. Hawes, 256 F. Supp. 366, 367 (E.D.N.C. 1966); Sims v. Charlotte Liberty Mut. Ins. Co., 257 N.C. 32, 40, 125 S.E.2d 326, 332 (1962); Rhinehardt v. North Carolina Mut. Life Ins. Co., 254 N.C. 671, 673, 119 S.E.2d 614, 616 (1961).

[13] Sims v. Charlotte Liberty Mut. Ins. Co., 257 N.C. 32, 40, 125 S.E.2d 326, 332 (1962); Rhinehardt v. North Carolina Mut. Life Ins. Co., 254 N.C. 671, 673, 119 S.E.2d 614, 616 (1961).

[14] 424 F.2d at 1007.

> were certainly sufficient to justify a lay patient to believe that a few weeks later, without an intervening sickness, he could say in good faith that he was not then suffering from "any physical deformities, impairments or ill health not recorded" in the catechism of 10 and 11.[15]

Although such an approach might be justified in light of *Jeffress v. New York Life Insurance Co.*,[16] it would appear that the court overstepped its function in passing upon the insured's good faith. When weighed against the evidence of the insured's medical history and his knowledge of the past diagnoses,[17] his good faith in responding to question 12 would not appear to be so overwhelming as to justify the appellate court's summary decision in the insured's favor.

In addition, the court's analysis of question number 12 would seem to permit recovery based upon the insured's bona fide belief of his *apparent* state of health. Besides being out of harmony with a number of other courts,[18] such an effect would seem to contradict *Hines v. New England Casualty Co.*,[19] upon which *Jeffress* relies.[20] In *Hines* the applicant for insurance had stated that he was in " 'sound condition, mentally and physically,' "[21] despite his knowledge of an existing hernia. In the insurer's subsequent suit to rescind the policy, the court held for the defendant, but added:

> Few people are absolutely exempt from some variation from a perfect condition, and, unless such variation is specifically asked about in the application and denied, it is not a matter vitiating the policy, unless the

---

[15] *Id.* at 1008.

[16] 74 F.2d 874 (4th Cir. 1935). "[W]here an inquiry as to physical condition or previous illness calls for what is in effect an opinion by the applicant, an answer made in good faith will not avoid the policy." *Id.* at 876.

[17] 424 F.2d at 1007.

[18] *E.g.*, Perkins v. John Hancock Mut. Life Ins. Co., 100 N.H. 383, 128 A.2d 207 (1956); National Life & Accident Ins. Co. v. Whitlock, 198 Okla. 561, 180 P.2d 647 (1947); Grover v. John Hancock Mut. Life Ins. Co., 119 Vt. 246, 125 A.2d 571 (1956).

> The rationale of the actual good health doctrine is that the parties, being free to contract as they pleased, have in unmistakable terms made the fact of good health a condition precedent to insurance coverage and that it is not within the province of the court, whatever its sympathies, to remake the insurance contract, either by deleting the good health clause or by reading into it language which is not there.

Wick, *The Good Health Clause—What it Says and What Some Courts Say it Says*, 23 INS. COUNSEL J. 311, 313 (1956) [hereinafter cited as Wick].

[19] 172 N.C. 225, 90 S.E. 131 (1916).

[20] 74 F.2d at 876.

[21] 172 N.C. at 226, 90 S.E. at 132.

> variation was serious enough to affect his "soundness" so that any one would say *who knew the facts*, "He is not a sound man."[22]

Thus, what began in *Hines* as a third party's opinion of *actual* health founded upon *scienter* has, in *Jeffress*, evolved to the point of permitting the applicant's statement of *apparent* state of health founded upon good faith *belief*.[23] Although the approach taken in *Jeffress* (and thereby, *Barden*) seems more in keeping with the policy behind section 58-30 of the North Carolina General Statutes,[24] the decision in *Hines* serves as a reminder of the jury's role as the trier of fact. In *Hines*, the jury was confined to determining whether the insured was or was not a sound man. With the subsequent liberalization of the rule in *Jeffress*, the jury should at least have been given the opportunity in *Barden* to decide whether the insured had a bona fide belief that he was in good health, and if so, whether such belief was reasonable.[25]

In passing upon the insurer's assertion of incompleteness in question 13, the court branded the inquiry as an "omnibus inquisition for details."[26] Such a label is misleading in light of the fact that treatment for slight or temporary indispositions may be regarded as immaterial where the applicant fully discloses medical treatment for a serious ailment administered at or about the same time.[27] Standing alone, therefore, question 13 requires that the applicant for insurance disclose only those facts and circumstances which, from a pragmatic standpoint, would be likely to affect the insurer's judgment in accepting the risk or in fixing the rate of the premium. Yet, in deciding that question thirteen was suitably answered in the context of question 10, the court only concerned itself with the insured's liver ailment. Nowhere did the court mention the diagnosis of

---

[22] *Id.* (emphasis added).

[23] *But cf.* Huffman v. State Capital Life Ins. Co., 8 N.C. App. 186, 174 S.E.2d 17 (1970). Decided one month after *Barden*, this case seems to imply a continued adherence to the actual good health doctrine. In support of this doctrine, it has been argued that the average layman both knows and understands the distinction between the term "good health" as used in daily conversation and "good health" as used in formal insurance contracts. The latter is understood to be a condition precedent to the enforceability of the contract and thereby could only mean actual good health. Wick at 317.

[24] N.C. GEN. STAT. § 58-30 (1965). See p. 562 *supra*.

[25] *Cf.* Franklin Life Ins. Co. v. William J. Champion & Co., 350 F.2d 115, 126 (6th Cir. 1965); Union Life Ins. Co. v. Davis, — Ark. —, —, 449 S.W.2d 192, 195 (1970).

[26] 424 F.2d at 1008.

[27] *E.g.*, Jeffress v. New York Life Ins. Co., 74 F.2d 874, 877 (4th Cir. 1935); Anthony v. Teachers' Protective Union, 206 N.C. 7, 11, 173 S.E. 6, 8 (1934).

a ruptured blood vessel in the stomach or esophagus or the insured's history of vomiting blood.[28] Certainly the former condition constitutes "stomach or intestinal trouble," and the facts of *Thomas-Yelverton Co. v. State Capitol Life Insurance Co.*[29] so closely parallel the latter symptom as to raise grave questions as to the court's propriety in omitting it from their analysis.

Similarly, the court explains away any culpability of the insured in failing to enumerate the circumstances surrounding the affirmative answers to question 11 by ruling that the insurer already had the equivalent of the information it sought.[30] Quoting from *Gouldin v. Inter-Ocean Insurance Co.*,[31] the court pointed out:

> Knowledge of facts which the insurer has or should have had constitutes notice of whatever an inquiry would have disclosed and is binding on the insurer. The rule applies to insurance companies that whatever puts a person on inquiry amounts in law to "notice" of such facts as an inquiry pursued with ordinary diligence and understanding would have disclosed.[32]

Although this argument is entitled to some weight in light of the insured's limited response to question 13, which in turn left his affirmative replies to question 11 unanswered, the court destroys much of its force by an earlier observation. In ruling that the insured had answered question 11 as fully as its broad phraseology would permit, the court admitted:

> Each of these rejoinders could well have been referable to the appendectomy. Likewise they could have related to the medical attention he received for liver troubles or to any of the possible maladies not appearing in question 10. No deception or half-truth is proved here.[33]

Although no deception or half-truth was proved in question 11, this same statement highlights the fallacy of the argument that the insurer was in possession of facts sufficient to put it on notice in question 13. It is true that insurance contracts are to be construed liberally in favor of the

[28] 424 F.2d at 1007.

[29] 238 N.C. 278, 77 S.E.2d 692 (1953). Here, the insured's negative response to a question pertaining to the existence of any diseases of the stomach was held to afford sufficient grounds for rescission on the insurer's showing that the insured had experienced the vomiting of blood in connection with a peptic ulcer.

[30] 424 F.2d at 1009.

[31] 248 N.C. 161, 102 S.E.2d 846 (1958).

[32] 424 F.2d at 1010.

[33] *Id.* at 1009.

insured.[34] But though the sword may cut sharper on the side of the insured, this does not necessarily imply that it cannot be double-edged at all. Just as the responses to question 11 might have alluded to either the insured's appendectomy or liver ailment, so too might the limited response to question 13 have indicated that the affirmative answers in question 11 were similarly limited to question 10(d). Inasmuch as the opinion of the individual insurer is favored over that of similar or reasonably prudent insurers upon the issue of materiality,[35] it would seem reasonable to afford the specific insurer an opportunity to show its interpretation of a disputed answer when the representation is deemed material as a matter of law.

Even assuming that the insurer did have a duty of inquiry, it could only be held to those facts which an investigation pursued with ordinary diligence would have disclosed.[36] Had it undertaken such an inquiry, it is highly doubtful that it would have obtained the vital information with which it was ultimately charged. The only details disclosed in question 13 concerned the insurer's hospitalization at Memorial Hospital under the care of Dr. Bell. Although an investigation of the hospital records would have revealed the insured's subsequent admittance for the vomiting of blood, it would have shown that he left the hospital apparently well and with no indications of his extensive liver ailment.[37] Nor is there any suggestion either that Dr. Bell was aware of the insured's later treatment by Dr. Weeks or that Memorial Hospital had any record of the insured's confinement at the other sanitarium.[38]

In its concluding remarks the court holds that even if the insured had concealed material facts, the insurer waived the defect and elected to treat them as immaterial.[39] It is clear that an insurer may waive provisions that are inserted in an insurance contract for its benefit.[40] By acting on an answer that is unresponsive or manifestly incomplete, an insurer precludes later objection on its part.[41] "But . . . the mere fact that the insurer has

[34] *E.g.*, National Bank v. Fidelity & Cas. Co., 125 F.2d 920, 923 (4th Cir. 1942); Suits v. Old Equity Life Ins. Co., 249 N.C. 383, 386, 106 S.E.2d 579, 582 (1959); Mills v. Metropolitan Life Ins. Co., 210 N.C. 439, 441, 187 S.E. 581, 582 (1936).

[35] Note, 5 U.C.L.A.L. REV., *supra* note 9, at 334 & n.15.

[36] Note, *Insurance—Insurer's Duty—Investigation for Suspected Fraud Prior to Issuance of Life Policy*, 10 ARK. L. REV. 499, 499-500 (1956).

[37] 424 F.2d at 1007.

[38] *Id.* at 1012 (dissenting opinion).

[39] *Id.* at 1010.

[40] *E.g.*, Bray v. North Carolina Police Voluntary Benefit Ass'n, 258 N.C. 419, 424, 128 S.E.2d 766, 770 (1963); Widows Fund of Sudan Temple v. Umphlett, 246 N.C. 555, 560, 99 S.E.2d 791, 794 (1957).

[41] Phoenix Life Ins. Co. v. Raddin, 120 U.S. 183, 190 (1887).

knowledge that some of the statements in an application are incorrect does not of itself put the insurer on inquiry, and charge it with knowledge of all the facts that an inquiry, would disclose."[42] Rather, it is the character of the information possessed by the insurer which is determinative.[43]

From the facts disclosed in the application, the insurer would have no occasion to suspect that the physician's recent discovery of the applicant's physical defects indicated an uninsurable condition. Instead, the more reasonable inference was that the affirmative answers in question 11 pertained to the applicant's only previous illness disclosed in the application, namely, the appendectomy in 1964. Such an inference is clearly supported in light of Barden's assertion of good health at the time of the application. These facts being insufficient to impose a duty of inquiry[44] and an investigation being unlikely to yield the vital information, it is difficult to justify the court's decision on the waiver issue. Waiver, being the voluntary relinquishment of a known right,[45] necessarily requires knowledge of the existence of that right and an intent to surrender it.[46] Without the requisite character of information (and no reason to obtain it), the insurer could hardly be held to have intentionally relinquished his equitable right to rescind.

Such a result-oriented decision as *Barden* is particularly difficult to reconcile with the basic notion of *uberrima fides*. Since the parties deal at arms length, the insurer must of necessity rely upon the applicant's good faith for its knowledge of the facts.[47] Prior to *Barden* a prime deterrent against a breach of this good faith was the knowledge on the part of the insured that should his misrepresentations be discovered within the contestable period, his wager with the insurer would yield no more than his total investment. The decision in *Barden*, however, effectively reduces the time allowed for the insurer's challenge and, in so doing, serves notice upon the clever but uninsurable applicant that the odds in his favor have been increased. By removing several questionable issues from the

[42] Provident Life & Accident Ins. Co. v. Hawley, 123 F.2d 479, 482-83 (4th Cir. 1941) (applying North Carolina law).

[43] *Id.* at 483.

[44] In *Hawley* the insurer inquired and learned that the insured had been cured of an affliction prior to the application but was not precluded from establishing a defense of a related illness that was undisclosed by both the insured and the prior investigation.

[45] 16A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 9081 (1968).

[46] Brady v. Funeral Benefit Ass'n, 205 N.C. 5, 7, 169 S.E. 823, 824 (1933).

[47] Comment, *Material Misrepresentation As a Requirement For Rescission of Insurance Contracts*, 73 DICK. L. REV. 250 (1969).

consideration of the jury, the policy manifested by section 58-30 of the North Carolina General Statutes has been stretched to an extreme.

WILLIAM W. MAYWHORT

Landlord and Tenant—Retaliatory Evictions and Housing Code Enforcement

The low income tenant in North Carolina must rely primarily upon municipal housing codes to ameliorate substandard housing conditions.[1] Although enforcement of code regulations has to some extent elevated the quality of existing urban housing, the process of repair under the codes, particularly for the benefit of the low income tenant, is hampered by the probability of considerable delay.

There may be delay between the first appearance of the defect and tne inspector's knowledge of the defect. Since a limited number of inspectors must inspect not only those dwellings suspected of being substandard but also all other housing in the city,[2] a general program of area inspections is tedious and time consuming. Therefore, inspectors are forced to rely upon reports of code violations from interested parties as an additional means of discovering violations. A tenant of adequate means, having a bargaining power equal to that of the landlord, is likely to repair himself or prompt his landlord to repair a serious defect rather than reporting it and awaiting municipal action under the enforcement process. But a low income tenant can seldom undertake repair; furthermore, a paucity of decent housing[3] may discourage him from antagonizing his landlord by reporting code violations.

The landlord might also retard the process of repair after the defect has been discovered by the inspector. A recalcitrant landlord of slum property will hesitate to expend money for repair of premises of only tenable value[4] and may take advantage of methods available under the

[1] Enabling legislation for municipal housing codes is found in N.C. GEN. STAT. § 160-182 (Supp. 1969).

[2] For example, there are six building inspectors to implement a program of city-wide housing inspection for the city of Durham. When the program is completed, it will have taken about ten years. Interview with Building Inspector for the City of Durham, North Carolina, Dec. 10, 1970.

[3] The North Carolina General Assembly has recognized that the state suffers from a housing shortage and that a substantial number of existing dwellings are in a substandard condition. N.C. GEN. STAT. § 157-2 (1966) (legislation enabling the establishment of municipal housing authorities).

[4] *See Symposium—Enforcement of Municipal Housing Codes*, 78 HARV. L. REV. 801 (1965).

housing codes to postpone enforcement.[5] After the inspector notifies the landlord of the nature of the violation, the landlord is entitled to a hearing before the inspector,[6] and if necessary, he may then be ordered to correct the defect within a specified time.[7] If the landlord fails to repair within the time allotted he may be granted an extension of the time.[8] If after the extension he fails to repair, he may be subject to a criminal penalty,[9] and the city may make the repairs at his expense[10] or force him to vacate the building.[11] However, the need for low-rent urban housing of any condition as well as a general sympathy toward landlords may contribute to the reluctance to employ these extreme measures of code enforcement.[12] During the periods of delay both before and after municipal recognition of the defect, the low income tenant must endure disrepair or quit the premises.[13] He can do little under the common law to stimulate accelerated action by his landlord.

Ignoring the possible disparities of bargaining power between the

[5] The enforcement process provided by the codes may involve uncomfortable delay for the tenant. To begin with, the officials must locate the owner or provide adequate means of notice of the violation if his whereabouts are unknown. *E.g.*, DURHAM, N.C., CODE § 10-8(9) (Supp. 1969). Of course, the owner must have an opportunity to contest the violation and adequate time to comply with an order of the inspector. *E.g.*, DURHAM, N.C., CODE §§ 10-8(5)-(7) (Supp. 1969). There may be further delay if the owner chooses to petition to the superior court for an injunction in restraint of carrying out an order. *E.g.*, DURHAM, N.C., CODE § 10-8(8) (Supp. 1969). Moreover, the inspector may not be permitted to exercise his duty to correct or remove a particular dwelling in violation of the code unless the city council orders by ordinance the inspector to proceed. *E.g.*, DURHAM, N.C., CODE § 10-10 (Supp. 1969).

[6] *E.g.*, DURHAM, N.C., CODE § 10-8(4) (Supp. 1969).

[7] *E.g.*, DURHAM, N.C., CODE § 10-8(5) (Supp. 1969). The time within which the owner must comply is left largely within the discretion of the inspector.

[8] *E.g.*, DURHAM, N.C., CODE §§ 10-8(6), (7) (Supp. 1969).

[9] *E.g.*, DURHAM, N.C., CODE §§ 10-8(6), (14) (Supp. 1969); GREENSBORO, N.C., CODE § 10-28 (1961). However, criminal penalties are rarely imposed upon the landlord. *See Symposium*, 78 HARV. L. REV., *supra* note 4, at 822-23. For example, in Durham criminal penalties have been imposed for violation of the housing code three times in the last eleven years. Interview with Building Inspector for the City of Durham, North Carolina, Dec. 10, 1970.

[10] *E.g.*, DURHAM, N.C., CODE § 10-8(11) (Supp. 1969). Durham does not resort to this remedy. Interview with Building Inspector for the City of Durham, North Carolina, Dec. 10, 1970.

[11] *E.g.*, DURHAM, N.C., CODE § 10-8(10) (Supp. 1969).

[12] In Durham, the owner who does not comply with an order to repair is generally given a continuance of the time originally granted for repairs. Interview with Building Inspector for the City of Durham, North Carolina, Dec. 10, 1970.

[13] The tenant himself may repair less serious defects, but for the low income tenant even minor repairs may be burdensome. California, for example, allows the tenant to make limited repairs and deduct the costs from rent payments. CAL. CIV. CODE §§ 1941-42 (West 1954).

landlord and the tenant,[14] the common law position was that the doctrine of caveat emptor applied to the lessee,[15] and in the absence of a covenant to repair the landlord had neither a duty to put the premises in a suitable condition prior to the lease[16] nor to maintain them thereafter.[17] The rationale for this position was that a tenant was not required to lease premises when he was dissatisfied with their condition, and if the landlord became responsible for disrepair subsequent to the tenant's going into possession, the tenant could abandon the premises and claim he had been constructively evicted by his landlord.[18] North Carolina courts have not rejected or significantly altered archaic common law concepts to cope with housing problems augmented by increasing urbanization. The tenant in North Carolina cannot claim a constructive eviction to recover rent paid for a defective dwelling unless he abandons the premises,[19] but the difficulty of finding alternative low-rent housing practically precludes abandonment. Furthermore, if the tenant relies upon the remedy of constructive eviction, he takes the risk that the court will not find in his favor after he has relinquished possession. In North Carolina, for example, gradual disrepair of the premises when the lessor has not covenanted to repair does not justify a claim of constructive eviction.[20] Consequently, if the tenant wishes to remain in possession, he is deprived of any effective remedy to force the landlord to comply with the dictates of the applicable municipal housing code.

North Carolina courts have been extremely reluctant to allow recovery by the tenant for personal injuries sustained as a result of a hazardous condition of the premises.[21] Even if the tenant has notified the landlord of defects and the landlord has agreed to repair but fails to do so, he is not liable for the tenant's injuries.[22] This rule extends to the situation where the landlord has specifically covenanted to repair (a covenant rarely undertaken in slum areas);[23] the courts have reasoned that com-

[14] *See generally* Kessler, *Contracts of Adhesion: Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

[15] See Note, *Landlord and Tenant—Recent Erosions of Caveat Emptor in the Leasing of Residential Housing*, 49 N.C.L. REV. 175 (1970).

[16] 1 AMERICAN LAW OF PROPERTY § 3.45 (A.J. Casner ed. 1952).

[17] *Id.* § 3.78.

[18] *Id.* § 3.51.

[19] Thompson v. Shoemaker, 7 N.C. App. 687, 690, 173 S.E.2d 627, 630 (1970).

[20] Carolina Mortgage Co. v. Massie, 209 N.C. 146, 183 S.E. 425 (1936).

[21] Rickman Mfg. Co. v. Gable, 246 N.C. 1, 97 S.E.2d 672 (1957).

[22] Moss v. Hicks, 240 N.C. 788, 83 S.E.2d 890 (1954).

[23] *See* Schoshinski, *Remedies for the Indigent Tenant: Proposals for Change*, 54 GEO. L.J. 519, 521 (1966).

pensation for physical injury is not assumed by the parties to the covenant.[24] The position advocated in North Carolina reflects the anomaly that a landlord who is already subject to a duty to the municipality to keep the premises in a safe condition is immune from liability to his tenant even though he has been negligent or dilatory in performing this duty.[25] Thus, the landlord may delay the process of code enforcement indefinitely without fear of tort liability due to his inaction.

Recently, the North Carolina Court of Appeals, in *Thompson v. Shoemaker*,[26] reaffirmed the common law position and held that violations of the housing code did not alter established common law doctrine. The court required abandonment of the premises to support a claim of constructive eviction[27] and ruled that a failure to abandon constituted contributory negligence barring any claim for physical injury.[28] The court failed to accept the plaintiff's argument that common law principles requiring abandonment are not fairly applicable because of the shortage of adequate housing by refusing to take judicial notice of any aspect of the city's housing situation.[29] The court should have taken such notice since the legislature took notice of the scarcity of decent housing when it passed enabling legislation for the establishment of public housing authorities.[30] Furthermore, the housing codes themselves provide that extensive deterioration may occur before destruction of the building becomes necessary.[31] Arguably, implicit in such provisions is the realization that current housing shortages demand that existing dwellings be retained if at all possible. It is interesting to note that in *Thompson* the unlawful defects of the dwelling had remained unrepaired for about a year,[32] and yet the tenant's only feasible remedy was to passively rely upon normal procedures of code enforcement.

---

[24] Jordan v. Miller, 179 N.C. 73, 75, 101 S.E. 550, 551 (1919).

[25] New York has held the landlord liable for injuries to the tenant when the proximate cause of the injuries was a defect in violation of the building code. Babba v. Yonkers Nat'l Bank & Trust Co., 265 App. Div. 829, 37 N.Y.S.2d 561 (1942) (mem.). *See also* Crawford v. Palomar, 7 Mich. App. 21, 151 N.W.2d 236 (1967).

[26] 7 N.C. App. 687, 173 S.E.2d 627 (1970).

[27] *Id.* at 690, 173 S.E.2d at 630.

[28] *Id.*

[29] *Id.*

[30] N.C. GEN. STAT. § 157-2 (1966).

[31] For example, the Code of the City of Wilmington provides that a dwelling may be repaired if the cost of repair does not exceed fifty per cent of the value of the building. WILMINGTON, N.C., CODE §§ 6-59, -60 (1961). The City of Greensboro allows repair if it does not exceed sixty per cent of the value of the building. GREENSBORO, N.C., CODE § 10-23(b) (1961).

[32] 7 N.C. App. at 689, 173 S.E.2d at 629.

If a tenant chooses to rely solely upon the process of code enforcement, he should personally report defects to code officials since area inspections may not uncover the defect for years.[33] However, to dispose of a troublesome tenant and to set an example for other tenants, the landlord would be within his common law right to evict the tenant who reports a violation after the expiration of his term[34] or to raise the rent so that the tenant could no longer afford to rent the premises.[35] North Carolina has summary ejectment statutes that set up the procedure by which a landlord may remove a tenant who holds over after his term has ended or who has failed to pay rent.[36] These statutes do not provide for the defense of a retaliatory motive on the part of the landlord. In North Carolina, the summary ejectment procedure is the exclusive remedy for removal and the landlord cannot employ self-help to evict a tenant.[37] Thus, the North Carolina legislature could, by foreclosing the right to summary ejectment in cases of retaliatory eviction or rent increase, protect the tenant who reports a housing code violation.

Even in the absence of legislative action, the North Carolina courts should consider the decisions of other jurisdictions and hold that, as a matter of statutory construction and for reasons of public policy, retaliatory evictions cannot be permitted.[38] Allowing the landlord to rely upon the summary ejectment statutes to thwart housing code enforcement would frustrate the saluatory purpose sought to be achieved by the state legislation enabling municipalities to adopt housing codes.[39] The difficulty with this argument is that any restriction of the summary ejectment statutes by the enabling statute must be implied since the statute makes no reference to the problem of evictions. Nevertheless, the courts might prevent retaliatory evictions without attempting to ascertain legislative intent simply by deciding that such evictions are against public policy.[40] Efficient opera-

[33] *See* note 2 *supra.*

[34] 1 AMERICAN LAW OF PROPERTY § 3.33 (A.J. Casner ed. 1952). *See* N.C. GEN. STAT. § 42-14 (1966), which sets out the applicable notice necessary to teminate a tenancy.

[35] 1 AMERICAN LAW OF PROPERTY § 3.64 (A.J. Casner ed. 1952).

[36] *See* N.C. GEN. STAT. §§ 42-26 to -37 (1966).

[37] North Carolina has held that a landlord is liable for damages when he employs self-help to evict a holdover tenant. Mosseller v. Deaver, 106 N.C. 494, 11 S.E. 529 (1889).

[38] *See* Edwards v. Habib, 397 F.2d 687 (D.C. Cir. 1968), *cert. denied,* 393 U.S. 1016 (1969); Schweiger v. Superior Court, 3 Cal. 3d 507, 476 P.2d 97, 90 Cal. Rptr. 729 (1970).

[39] N.C. GEN. STAT. § 160-182 (Supp. 1969).

[40] Edwards v. Habib, 397 F.2d 687, 699 (D.C. Cir. 1968).

tion of code enforcement procedures necessitates a freedom of access by aggrieved parties to enforcement officials.

Perhaps the courts have valid reasons for declining to qualify the common law right of the landlord, for in the absence of relevant and comprehensive statutes, judicial decisions cannot immediately resolve exigent issues.[41] Statutory reform in North Carolina could prompt more effective enforcement of the housing codes by granting the tenant the right to refuse to pay rent to the landlord for a dwelling that violates the housing code.[42] To allow the tenant complete freedom from payment of rent would permit him to abuse the protection intended by the statute since he would have nothing to lose by committing waste and remaining in possession with no bona fide intention to pay rent. On the other hand, a rent escrow provision would require the tenant to pay rent as usual; however, this rent would go into the fund rather than directly to the landlord.[43] This fund could then be applied to the cost of any necessary repairs. To be given maximum effect a statute providing for a rent escrow agreement should be supplemented by a provision specifically prohibiting the landlord from evicting the tenant, raising the rent, or requiring additional lease obligations in retaliation for the tenant's reporting code violations.[44]

Because the landlord normally has access to records of expenses related to the property, to evidence of proposed changes of investments or use of the property, or has knowledge of specific instances of waste by the tenant, the burden of going forward on the issue of a retaliatory motive should shift to the landlord after the tenant has established his reporting of code violations and the subsequent attempted evictions by the landlord. Following an attempted wrongful eviction or after the establishment of the escrow agreement the presumption of a retaliatory motive should dissipate only after the passage of a reasonable amount of time.[45] Of course, if the owner wishes to remove his property from the

[41] One issue not decided in *Habib* was how long the tenant could remain in possession after he had reported housing code violations. The dissenting opinion strongly argued that the court should have waited for legislative action. *Id.* at 703-05.

[42] *See, e.g.*, MASS. GEN. LAWS ANN. ch. 111, § 127F (Supp. 1969); N.J. STAT. ANN. § 2A: 170-92.1 (Supp. 1969); PA. STAT. ANN. tit. 35, § 1700-1 (Supp. 1970); R.I. GEN. LAWS § 34-20-10 (1968).

[43] *E.g.*, MASS. GEN. LAWS ANN. ch. 111, § 127F (Supp. 1969); PA. STAT. ANN. tit. 35, § 1700-1 (Supp. 1970).

[44] *E.g.*, MICH. STAT. ANN. § 27A.5646 (Supp. 1970).

[45] *See* ABF MODEL RESIDENTIAL LANDLORD-TENANT CODE § 2-407(1) (Tent. Draft 1969). The Model Code provides for a period of six months.

housing market, no construction of the statute should interfere with his right to do so.

The suggested statutory provisions would involve an extremely delicate balancing of the rights of the landlord and tenant. But if interpreted in light of the policies underlying existing municipal housing codes, the laws would not unduly restrict property rights. The end result would be more effective compliance with housing code standards, and for the landlord who maintains these standards, his common law rights against the tenant would be preserved.

CHRISTIAN NESS

Labor Law—Duty to Bargain About Changes in Benefits for Retired Employees

Suppose that employees, who are members of a collective bargaining unit, are permitted, pursuant to the terms of a collective bargaining agreement, to remain members of an employee group health insurance plan with the employer making monthly contributions for them when they retire. Congress thereafter enacts legislation that entitles these retired employees to certain health care benefits that duplicate some of the benefits of the group plan. The employer, concerned about the welfare of his former employees, wishes to substitute new benefits for those duplicated. Does he, under the Labor Management Relations Act (the Act),[1] have a duty to bargain with the union representing the employees about the proposed change? This question arose for the first time in the history of the Act in the recent case of *Pittsburgh Plate Glass Co., Chem. Div. v. NLRB*.[2]

Since 1949, Local Union No. 1, Allied Chemical and Alkali Workers of America, had been the exclusive bargaining representative of Pittsburgh Plate Glass Company's employees at the Barberton, Ohio plant and mine.[3] A contract was negotiated in 1950 that included provisions for a group health insurance plan for employees; there was also an oral agreement that retired employees could participate in the plan but would bear the entire cost of such participation. In 1959 an improvement in the

[1] 29 U.S.C. §§ 141-87 (1964).

[2] 427 F.2d 936 (6th Cir. 1970), *cert. granted*, 39 U.S.L.W. 3353 (U.S. Feb. 23, 1971) (Nos. 910, 961).

[3] *Id.* at 938.

coverage was negotiated and the participation rights of retirees was reduced to writing. In 1962 a contract was negotiated that required the company to contribute two dollars per month to the plan for employees retiring after the effective date of the contract; this contract also provided for mandatory retirement at age sixty-five. A contract signed in 1964 provided for an increase in the company's contribution for retired employees to four dollars per month with a stipulation that the company might rescind the increase should pending Medicare legislation be enacted. Shortly after the enactment of Medicare,[4] the union notified the company that it wished to engage in mid-term bargaining about the health plan for retired employees. When the parties finally met the company announced that it would, pursuant to the contract, discontinue the increased payments when Medicare took effect and that it would remove the retired employees from the group health plan, paying them three dollars per month for supplemental Medicare benefits in lieu of the two dollars per month contribution. Challenging the union's right to bargain about the matter at all, the company subsequently decided to offer the retirees, on an individual basis, the option of remaining in the group plan or electing to take the three dollar per month payment from the company. This offer was made to 190 retirees; fifteen elected to take the supplemental benefit payments. During this time the union continued to insist that the company bargain with it about any changes and finally filed charges with the NLRB alleging that the company's actions were unfair labor practices prohibited by the Act.

Specifically, the company was charged with violating section 8(a)(5) of the Act, which makes it an unfair labor practice for an employer "to refuse to bargain collectively with representatives of his employees, subject to the provisions of section 9(a)."[5] Section 9(a) provides that the bargaining representative chosen by the majority of the employees in an appropriate unit shall be the exclusive representative of all the employees in that unit for purposes of collectively bargaining about rates of pay, wages, hours of employment, or other conditions of employment. The company's actions were said to have violated its duty to bargain in three ways. First, the company's action was presumably a unilateral modifica-

[4] Health Insurance for the Aged Act, 42 U.S.C. §§ 1395-96 (Supp. III 1965-67).

[5] National Labor Relations Act [hereinafter NLRA] § 8(a)(5), 29 U.S.C. § 158(a)(5) (1964). There was also a charge that the company had violated section 8(a)(1), which forbids interference, coercion, or restraint of the right of employees to organize and bargain collectively.

tion of an existing, valid collective bargaining agreement and thus was a per se violation of the duty to bargain.[6] Second, the retirement benefits in question were so inextricably bound up with the wages and other conditions of employment of the active employees that the company presumably had a duty to bargain with the representatives of the active employees about such changes. Third, the retirees were employees within the meaning of the Act, and the union was their collective bargaining representative. Therefore, since their benefits were wages, the company had a duty to bargain about any changes in their benefits.

The Board found the company guilty of the charged violations apparently on all three grounds and ordered the company to cease and desist from refusing to bargain with the union on the subject.[7] The company sought review of the Board's order in the Court of Appeals for the Sixth Circuit and the Board cross-petitioned for enforcement. The court, largely confining its decision to whether the company could be required to bargain with the union as the representative of the retried employees,[8] failed to agree with the Board on any theory and denied enforcement of the order.[9]

Reading the appropriate sections of the Act it appears that in order to find that an employer has a duty to bargain with a union about modifications in the benefits of retirees four conditions must be satisfied; (1) the retirees in question must be "employees" within the meaning of section 2(3) of the Act;[10] (2) they must be the employer's employees within the

[6] NLRA § 8(d), 29 U.S.C. § 158(d) (1964), provides in part: "the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract [without bargaining about it] . . . ."

[7] 71 L.R.R.M. 1433 (1969).

[8] The court dismissed the theory that the company's action was a unilateral modification of the collective bargaining contract by implying that the retiree's benefits vest upon retirement as personal contract rights, and that it was the personal contract rights that had been modified by agreement of the parties. 427 F.2d at 942 n.9.

The court did not mention the possibility of upholding a violation of the duty to bargain with the active employees on the ground that the company's action unilaterally modified the base group of the employees' group health plan. *See* Combined Paper Mills, Inc., 70 L.R.R.M. 1209 (1969). No reason for this omission appears in the opinion, and the Board has reasserted this position in its petition for certiorari. 75 LAB. REL. REP. 284, 285 (Dec. 7, 1970).

[9] The Board has decided to adhere to its ruling pending resolution by the Supreme Court. See 75 LAB. REL. REP. 201 (Nov. 9, 1970).

[10] 29 U.S.C. § 152(3) provides:

> The term 'employee' shall include any employee, and shall not be limited to the employees of a particular employer, unless *this subchapter* explicitly states otherwise, and shall include any individual whose work has ceased as a consequence of, or in connection with, any current labor dispute or

meaning of section 8(a)(5) of the Act;[11] (3) they must be members of the certified bargaining unit;[12] and (4) their benefits must be included in the phrase "wages, hours, and other terms and conditions of employment."[13]

The language of section 2(3) neither specifically includes nor excludes retired employees. It is settled that Congress did not use the word as a term of art having a definite meaning,[14] and apparently Congress did not anticipate this problem so that legislative intent provides little help in deciding whether the term is broad enough to include retirees.[15] There are numerous cases, dealing with other labor problems, which find that persons who would not ordinarily be thought to be described by the term "employees" are covered by the Act, but these cases deal primarily with workers who are likely to be employed in the near future.[16] There are a few cases, however, holding that "employees" as used in section 302(c)

---

because of any unfair labor practice, and who has not obtained any other regular and substantially equivalent employment, but shall not include any individual employed as an agricultural laborer, or in the domestic service of any family or person at his home, or any individal employed by his parent or spouse, or any individual having the status of an independent contractor, or any individual employed as a supervisor, or any individual employed by an employer subject to the Railway Labor Act, as amended from time to time, or by any person who is not an employer as herein defined.

29 U.S.C. § 152(3) (1964) (emphasis added). The italicized words appear in 612 Stat. 137 as "this Act."

[11] 29 U.S.C. § 158(a)(5) (1964), makes it an unfair labor practice for an employer "to refuse to bargain collectively with the representatives of his employees, subject to the provisions [of section 9(a)]."

[12] NLRA § 9(a), 29 U.S.C. § 159(a) (1964), provides in part:

Representatives designated or selected for the purposes of collective bargaining by the majority of the employees in a unit appropriate for such purposes, shall be the exclusive representatives of all employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment . . . .

[13] There is a mandatory duty to bargain about subjects included in the phrase "wages, hours, and other terms and conditions of employment." NLRB v. Wooster Div. of Borg-Warner Corp., 356 U.S. 342, 349 (1958).

[14] NLRB v. Hearst Publications, Inc., 322 U.S. 111, 124 (1944).

[15] Legislative histories of the Wagner and Taft-Hartley Acts compiled by the Board give no indication that Congress in any way anticipated this problem. NATIONAL LABOR RELATIONS BOARD, LEGISLATIVE HISTORY OF THE NATIONAL LABOR RELATIONS ACT, 1935 (1949); NATIONAL LABOR RELATIONS BOARD, LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT, 1947 (1948).

[16] *E.g.*, Phelps Dodge Corp. v. NLRB, 313 U.S. 177 (1941) (applicants for employment); Whiting Corp. v. NLRB, 200 F.2d 43 (7th Cir. 1952) (men laid off not reasonably expected to return to work not employees); Goodman Lumber Co., 166 N.L.R.B. 304 (1967) (person who has quit); Local 872, International Longshoremen's Ass'n, 163 N.L.R.B. 586 (1967) (hiring hall registrants).

of the Act[17] includes retired employees.[18] One of these, *Blassie v. Kroger Co.*,[19] conceptualizes the term employee as referring to one being in an employment relationship with another. That relationship contemplates an exchange of work for wages with reciprocal performances normally occurring at the same point in time. Should the performances be separated in time however the relationship continues until performance by both sides is completed. Thus a retired employee retains, to some extent, the status of employee until all benefits—deferred wages[20]—due him are paid.

The court in *Pittsburgh* did not directly challenge the assertion that persons not currently in the active service of an employer could be covered by the term "employee." It chose to draw the line at section 8(a)(5), which speaks of "representatives of *his* employees."[21] The court noted that this language has not been given the same expansive reading accorded the word "employee" without the possessive pronoun. So far as the court was concerned retirement "is a complete and final severance of employment."[22] Thus, even if retirees are "employees" this severance from the employer means that they are not "his employees." The application of the *Blassie* rationale was rejected by the court because it viewed that case as an ad hoc decision necessary to carry out the obvious intent of section 302(c) of the Act. However, there seems to be no necessity for rejecting the rationale in *Blassie* to protect the obvious purpose of the restrictive language of section 8(a)(5)—limiting the employer's duty to bargain to persons he has employed as opposed to those he has not yet employed or those employed by others. Nevertheless, the Board, as the court pointed

[17] 29 U.S.C. § 186(c) (1964). Section 302 of the Act is generally concerned with preventing the misuse of bargaining power for the personal or political purposes of union officials; it therefore restricts certain loans and payments by employers to, *inter alia*, employee representatives, labor organizations and their officials. Subsection (c) excepts certain types of payments including certain types of welfare funds; it provides in part:

> The provisions of this section shall not be applicable . . . with respect to money or other thing of value paid to a trust fund established by such representative, for the sole and exclusive benefit of the *employees* of such employer, and their families and dependents . . . .

Id. (emphasis added).

[18] *E.g.*, Garvison v. Jensen, 355 F.2d 487 (9th Cir. 1966); Blassie v. Kroger Co., 345 F.2d 58 (8th Cir. 1965).

[19] 345 F.2d 58, 68-71 (8th Cir. 1965) (Blackmun, J.).

[20] Benefits to be enjoyed upon retirement are considered deferred wages for the purposes of the Act. Inland Steel Co., 77 N.L.R.B. 1 (1948), *enforced*, 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949).

[21] 29 U.S.C. § 158(a)(5) (1964) (emphasis added).

[22] 427 F.2d at 944.

out, has never permitted retirees to vote in certification elections but has excluded them from the bargaining unit. However, the cases cited by the court[23] are of doubtful value. The most recent case involved a retired employee whose only connection with the employer was that he worked irregularly to make the maximum allowed by Social Security regulations; he was excluded because of the irregularity of his work.[24] The other cases were all decided before the Board determined that retirement benefits were a mandatory subject of bargaining with active employees.[25]

Since there is no duty to bargain about the interests of those not in the bargaining unit,[26] the continuing employment concept may be used to avoid that pitfall by stating that retired employees have never completely left the bargaining unit. The court, however, believed that retirees have left the unit and, furthermore, that they lack the economic credentials to reenter it. In the court's view retired employees are not included in the description of the certified unit,[27] and, in case the Board may be said to have changed the unit, such action would be inappropriate because the "appropriate unit has economic incidents which the Board simply cannot modify by fiat or enlarge by sympathy."[28]

Finally, the subject of bargaining—modification of the retirees' benefits—must be wages, hours or other terms and conditions of employment. Retirement benefits are deferred wages and are treated no differently than those of active employees if the continuing employment concept is accepted. In the court's view, however, they are no longer wages as such but vested contract rights,[29] outside the field of industrial relations.

On the basis of its textual analysis of the provisions of the Act, the

[23] Taunton Supply Corp., 137 N.L.R.B. 221 (1962); Public Service Corp., 72 N.L.R.B. 224 (1947); J.S. Young Co., 55 N.L.R.B. 1174 (1944); W.D. Byron & Sons, 55 N.L.R.B. 172 (1944).

[24] Taunton Supply Corp., 137 N.L.R.B. 221 (1962).

[25] The Board decided in Inland Steel Co., 77 N.L.R.B. 1 (1948), that retirement benefits were actually a form of wages and therefore a mandatory subject of bargaining.

[26] Douds v. International Longshoremen's Ass'n, 241 F.2d 278 (2d Cir. 1957).

[27] The certified bargaining unit was "[a]ll employees of the Employer's plant and limestone mine at Barberton, Ohio working on hourly rates, including group leaders who work on hourly rates of pay, but excluding salaried employees and supervisors within the meaning of the Act." 427 F.2d at 938.

[28] *Id.* at 946. The court did not describe those incidents; it is presumed that they are not present here.

[29] For a discussion of how vested these benefits may, or may not be in various situations see B. AARON, LEGAL STATUS OF EMPLOYEE BENEFIT RIGHTS UNDER PRIVATE PENSION PLANS (1961).

court's position emerges as a defender of the plain meaning of language[30]—retired means no longer employed and retirement benefits are contract rights, not wages. The Board, on the other hand, is more liberal with the language and feels that retirement under a collective bargaining agreement providing retirement benefits is not a complete severance of the employment relationship, thus leaving room for a continuing obligation to bargain during the life of the benefits. Neither view is completely unreasonable, nor patently correct; therefore, recourse must be had to the purposes of the Act and the economic facts of the situation. The Board is the expert to which Congress has given the duty of making such decisions; it has broad discretion and should be overruled by reviewing courts only when there is no substantial evidence to support its position, or when it contravenes the provisions of the Act.[31]

The Act is primarily designed to promote industrial peace and stability by encouraging collective bargaining.[32] The adequacy of retirement benefits poses a threat to industrial peace in that retired employees have very few places to look, other than to the employer or the community, should their benefits prove to be inadequate. Particularly in this day of confrontation, it is not unlikely that industrial peace literally could be shattered by disgruntled pensioners; picketing alone could persuade many employees to refuse to go to work. The Act does not require the Board to await actual disruption or violence but allows it to be anticipated.[33] Additionally, the experience of the retired employees, viewed from the standpoint of the active employees, undoubtedly has an impact upon the willingness of active employees to accept mandatory retirement as well as a given pension plan; thus, their insecurity may well lead to industrial strife. Indeed Congress has recognized as much by stating that employee welfare and pension benefit plans are an "important factor affecting the stability of employment and the successful development of industrial relations."[34] Collective bargaining is "the framework established by Congress as most conducive to industrial peace."[35] The Supreme Court has also unanimously indicated that "[i]ndustrial experience is not only reflective

[30] "There was nothing strained or unnatural in this interpretation." 427 F.2d at 943.

[31] NLRB v. E.C. Atkins & Co., 331 U.S. 398, 403-04 (1947); NLRB v. Hearst Publications, Inc., 322 U.S. 111, 130-31 (1944).

[32] Fiberboard Paper Prod. Corp. v. NLRB, 379 U.S. 203, 211 (1964); Carey v. Westinghouse Elec. Corp., 375 U.S. 261, 271 (1964).

[33] NLRB v. Bradford Dyeing Ass'n, 310 U.S. 318, 326 (1940).

[34] Welfare and Pension Plans Disclosure Act, 29 U.S.C. § 301(a) (1964).

[35] Fiberboard Paper Prod. Corp. v. NLRB, 379 U.S. 203, 211 (1964).

of the interests of labor and management in the subject matter but is also indicative of the amenability of such subjects to the collective bargaining process."[36] There is evidence that many industries do bargain about modification of retirees' benefits; indeed, the parties in the instant case did so for a number of years.[37]

The court adopted a somewhat different approach to the purpose of the Act, emphasizing the equalization of competing economic forces. The Act's "purpose is not artificially to create or manufacture new economic forces," and "[r]etired employees have no economic or bargaining power within this system."[38] This position is related directly to the court's textual analysis and can be reduced to a flat assertion that the court did not believe that retirees were intended to be protected by the Act. Such a view avoids rather than answers the assertion that this subject constitutes a threat to industrial peace. Further, the court doubted that the subject is suited to collective bargaining at all or, in any event, that the union is the appropriate vehicle for such collective bargaining. First, the court reasoned that collective bargaining would destroy the security that the retiree has with a vested contract right because benefits could be decreased through bargaining as well as increased; second, it feared that union negotiators would be likely to favor the interests of active dues paying members over those of the retired employees. It should be noted, however, that the security of a vested contract right may well be minimal, particularly where the enforcement of that right depends on the resources of the individual rather than the resources of a group.[39] Additionally, it should be noted that the representative of a bargaining unit has the duty to fairly represent the interests of all members of that unit.[40] Moreover, there seems to be no advantage to anyone in excluding retirees from the unit since the economic power of the retirees eventualy rests on the cooperation of the active employees and since it will certainly be simpler for the company to deal with one union rather than two.

---

[36] *Id.*

[37] *See* Pittsburgh Plate Glass Co., Chem. Div., 71 L.R.R.M. 1433, 1437 (1969), and authorities cited there.

[38] 427 F.2d at 946.

[39] Even where the employer performs his obligation voluntarily, the security of a vested right to a fixed payment may be slight in periods of continuing inflation. Based on the Consumer Price Index, a worker who retired in 1959 with a food budget of one hundred dollars per month would have had to pay 129.80 dollars for the same food in October, 1969, and his health costs would be 56.9 per cent higher than when he retired. *See* U.S. BUREAU OF LABOR STATISTICS, MONTHLY LABOR REVIEW, Dec., 1969, at 100.

[40] Vaca v. Sipes, 386 U.S. 171, 177 (1967).

A determination that the retired employees in this case are covered by the Act and that their benefits are mandatory subjects of bargaining raises quite a few questions that neither the Board nor the court has answered. For example; does the principle apply to all industrial pensioners or only to those pensioned pursuant to a collectively bargained contract; will pensioners now be allowed to participate in certification elections, and, if so, to what extent; may the parties bargain for a decrease in benefits, and may the employer decrease them if there is an impasse in bargaining? No reason appears why these questions must be settled before they arise in an actual case and, thus, the existence of these and other questions should not prevent affirmance of the Board's decision.

The court set forth no convincing arguments that the Board's decision will not effectuate the policies of the Act unless one accepts the premise that retirees were never intended to be protected by the Act. It is difficult to say that the Board's position is unreasonable or even unsupported by substantial evidence. Therefore, in a close case such as this the court should defer to the policy determinations of the Board. If the Board has acted contrary to the will of Congress, Congress has the power to overrule the Board.

GEORGE S. KING, JR.

Workmen's Compensation—What Is the Range of Compensable Consequences of A Work-Related Injury?

The North Carolina Court of Appeals in *Starr v. Charlotte Paper Co.*[1] recently considered the extent to which an employer, liable for the first injury, may be held accountable under the North Carolina Workmen's Compensation Act for secondary injuries subsequently incurred by its former employee. On October 8, 1963, while employed by the defendant, Starr suffered a spinal injury causing total paralysis from the waist down. In lieu of weekly compensation benefits, Starr settled with the employer for thirty-five thousand dollars. The North Carolina Industrial Commission entered an order approving the settlement with the exception that it was not in satisfaction of subsequent hospital and nursing expenses incurred as a result of the injury.

Due to his condition, Starr could move about only with the aid of a wheelchair and had frequent muscle spasms in his legs. On March 17,

[1] 8 N.C. App. 604, 175 S.E.2d 342, *cert. denied*, 277 N.C. 112, — S.E.2d — (1970).

1969, six years after the first injury, he was awakened by muscle spasms which he managed to quiet by massaging his legs. The claimant then lit a cigarette. When his legs again began to contract, he placed the cigarette in an ash tray on his wheelchair beside the bed and again massaged his legs. After he drifted off to sleep, his sheets came into contact with the cigarette and began smoldering. Starr was finally awakened by the smell of smoke but by this time had suffered second and third degree burns over the lower half of his body, which resulted in his being hospitalized for seventy-three days.

The claimant brought a claim against his former employer for the hospital expenses and was awarded compensation by the Industrial Commission. Charlotte Paper Co. appealed, charging that the previous accident was not the proximate cause of the claimant's subsequent injuries, but that they were proximately caused by his smoking in bed. In affirming the award, the North Carolina Court of Appeals relied on a liberal construction of the workmen's compensation act to find that the injury "arose out of" the employment.[2] Noting that the claimant's failure to properly extinguish the cigarette was a "simple act of forgetfulness,"[3] the court stated that recovery was allowed even when the employment was not the "sole causative force"[4] of an injury. In addition, the court held that every direct and natural consequence of a prior injury is compensable unless there has been an intervening cause attributable to "claimant's own intentional conduct."[5] Any negligence on the part of the claimant not amounting to intentional conduct was thus disregarded.[6]

The North Carolina Workmen's Compensation Act allows recovery for "injuries by accident arising out of and in the course of employments."[7] "Arising out of" as used in the act requires that the injury have its origin in the employment,[8] be traceable to the employment,[9] or spring from the employment.[10] Thus, an injury occurring subsequent in time to

[2] *Id.* at 609-10, 175 S.E.2d at 346.
[3] *Id.*
[4] *Id.*
[5] *Id.* at 611, 175 S.E.2d at 347.
[6] *Id.*
[7] N.C. GEN. STAT. § 97-2(6) (1965).
[8] Taylor v. Twin City Club, 260 N.C. 435, 438, 132 S.E.2d 865, 868 (1963); Vause v. Vause Farm Equip. Co., 233 N.C. 88, 91, 63 S.E.2d 173, 175 (1951).
[9] Horn v. Sandhill Furn. Co., 245 N.C. 173, 176, 95 S.E.2d 521, 523 (1956); Poteete v. North State Pyrophyllite Co., 240 N.C. 561, 564, 82 S.E.2d 693, 694 (1954); Eaton v. Klopman Mills, Inc., 2 N.C. App. 363, 368, 163 S.E.2d 17, 20 (1968).
[10] Perry v. American Bakeries Co., 262 N.C. 272, 273, 136 S.E.2d 643, 645 (1964).

the prior compensable injury would have its origin in the employment if there were "some causal relation"[11] between the two injuries. One cause of Starr's burns was the muscle spasms that awakened him and arguably led to his failure to extinguish the cigarette. Furthermore, he would have been awakened by the burning of his flesh had he any feeling in his legs.[12] Thus, there was "some causal relation" between the injury and the prior compensable injury, so that the burns could be said to have "arisen out of the employment."

The real difficulty of analysis in statutory terms is encountered when the "in the course of the employment" inquiry is made. "In the course of the employment" refers to the time, place, and circumstances of the accident.[13] Because secondary injuries of the type under consideration here do not occur in the job context, some courts limit their inquiry to a determination of whether the injury arose out of the employment,[14] indicating that all that is necessary for recovery for subsequent injuries is caustion in the but-for sense. "So long as the original injury operates even in part as a contributing factor [of the second injury] it establishes liability."[15] Using this language, recovery for the subsequent swimming death of a quadruple amputee could be allowed if his limbs had been lost as a result of a prior compensable injury. A man with a broken hand could recover for re-injury incurred as a result of a boxing match,[16] or one suffering from vertigo as a result of a prior injury could recover for subsequently falling off a ladder.[17] If some inquiry in addition to "arising out of the employment" is not made, recovery for the off-the-job injury will be broader than for the original injury,[18] and workmen's compensation

[11] *Id.*

[12] 8 N.C. App. at 609, 175 S.E.2d at 346.

[13] Harless v. Flynn, 1 N.C. App. 448, 455, 162 S.E.2d 47, 52 (1952).

[14] *See, e.g.*, State Comp. Ins. Fund v. Industrial Acc. Comm'n, 1 Cal. Rptr. 73, 176 Cal. App. 2d 862 (1959); Colvin v. Emmons & Whitehead, 216 App. Div. 577, 215 N.Y.S. 562 (Sup. Ct. 1926).

[15] State Comp. Ins. Fund v. Industrial Acc. Comm'n, 176 Cal. App. 2d 862, —, 1 Cal. Rptr. 73, 78 (1959).

[16] 1 A. LARSON, LAW OF WORKMEN'S COMPENSATION § 13.11, at 192.65-.66 (1968) [hereinafter cited as LARSON].

[17] Colvin v. Emmons & Whitehead, 216 App. Div. 577, 215 N.Y.S. 562 (Sup. Ct. 1926). *See also* Note, *Workman's Compensation: Arising out of Employment: Chain of Causation between Compensable Injury and Subsequent Injury, Aggravation or Reinjury: Negligence of Workman as Independent Intervening Cause: Swanson v. Williams & Co., 278 App. Div. 477, 106 N.Y.S.2d 61 (3d Dep't 1951), aff'd without opinion, 304 N.Y. 624, 107 N.E.2d 96 (1952)*, 38 CORNELL L.Q. 99 (1952).

[18] Recovery is not allowed for the original injury if it was occasioned by intoxication or if it was willfully inflicted. If "arising out of the employment" is the only

will be extended into the proscribed field of general health and accident insurance.[19]

Due to the nonapplicability of the "in the course of the employment" inquiry to subsequent off-the-job injuries and the recognition that all secondary injuries were not intended to be compensable,[20] courts have sought some concept to limit the employer's liability for a causally related injury.[21] Accordingly, the North Carolina Court of Appeals, and most other courts considering the problem, require that in addition to "some causal relation" the subsequent injury be proximately caused by the prior compensable injury.[22] "The proximate cause doctrine . . . requires that the original injury be one of the direct and natural causes of the subsequent injury,"[23] or compensation will be denied.[24]

Thus, there is a reentry of common law proximate cause into the formula for recovery under the workmen's compensation acts. One element of proximate causation is foreseeability. Foreseeability was eliminated by the North Carolina act as a requirement for compensation for on-the-job injuries[25] because it is

---

requirement for compensability for a subsequent injury, recovery might be allowed where it was in part occasioned by the employee's intoxication under a literal application of this language. N.C. GEN. STAT. § 97-12 (1965).

[19] Workmen's Compensation Acts are not to be construed so liberally as to provide general health and accident insurance. Bryan v. First Free Will Baptist Church, 267 N.C. 111, 115, 147 S.E.2d 633, 635 (1966); Martin v. Georgia-Pacific Corp., 5 N.C. App. 37, 41, 167 S.E.2d 790, 792-93 (1969). *See generally* Note, 38 CORNELL L.Q., *supra* note 17, at 103-04.

[20] *See* authorities cited note 19 *supra.*

[21] Arguably, there are several provisions in the North Carolina Workmen's Compensation Act that evidence a legislative intent that subsequent injuries not be compensable at all. *See* N.C. GEN. STAT. § 97-24(a) (1965) (all claims are barred unless filed within two years of a compensable accident); § 97-24(c) (1965) (all records of the Industrial Commission can be destroyed five years after all reports are filed); § 97-47 (1965) (an employee can move for review of the award if there has been a change in his condition). *See also* Lee v. Roses 5-10-25¢ Stores, 205 N.C. 310, 171 S.E. 87 (1953).

[22] *See, e.g.*, Great A&P Tea Co. v. Hill, 201 Md. 630, 636, 95 A.2d 84, 87 (1953); Dickerson v. Essex Co., 2 App. Div. 2d 516, —, 157 N.Y.S.2d 94, 96 (Sup. Ct. 1956); Gower v. Mackes, 184 Pa. Super. 41, 45-46, 132 A.2d 880, 882 (1957).

[23] 8 N.C. App. at 610, 175 S.E.2d at 347. *See also* Coble v. Player Realty & Constr. Co., North Carolina Industrial Acc. Comm'n Docket No. A-7243 (1951).

[24] *See, e.g.*, Yarbrough v. Polar Ice & Fuel Co., 118 Ind. App. 321, 79 N.E.2d 422 (1948); Adkins v. Rives Plating Corp., 338 Mich. 265, 61 N.W.2d 117 (1953); Sullivan v. B&A Constr., Inc., 307 N.Y. 161, 120 N.E.2d 694 (1954). *See also* Note, *Workmen's Compensation—Accident or Injury and Consequences Thereof—Subsequent Injuries*, 19 U. CIN. L. REV. 304, 305 (1950).

[25] North Carolina does not require that the original injury be foreseeable. *See, e.g.*, Taylor v. Twin City Club, 260 N.C. 435, 438, 132 S.E.2d 865, 868 (1963); Withers v. Black, 230 N.C. 428, 433, 53 S.E.2d 668, 672 (1949); Ashley v. F-W

> out of place in compensation law because, as developed in tort law, it [is] a concept which [is] . . . thoroughly suffused with the idea of fault; that is, it [is] a theory of causation designed to bring about a just result when starting from an act containing some element of fault. The primary test of legal cause in the United States is foreseeability . . . . [b]ut foreseeability has no relevance if one is not interested in the culpability of the actor's conduct.[26]

Since the fault of the employer is equally irrelevant in the context of secondary injuries, common law foreseeability has no place in the determination of compensability. With the dismissal of foreseeability, proximate cause is limited to meaning the absence of an intervening cause.[27]

Once the doctrine of intervening cause raises its head, the employee's negligence as an intervening cause must be reckoned with even though the workmen's compensation acts eliminated any inquiry into negligence in the formula for recovery. "[N]ot even gross negligence is [to be] a defense to a compensation claim."[28] Courts have avoided this seemingly anomalous situation by asserting that the inquiry into employee negligence is not made to bar recovery for contributory negligence but to determine the legal cause of the claimant's injury—his own intervening negligence or the prior injury.[29] Accordingly, most courts have required something more than mere negligence by the employee to break the chain of causation and relieve the employer of liability.[30] What constitutes mere negligence is determinative of liability in most subsequent injury cases. Thus, the court of appeals in *Starr* held that Starr's failure to extinguish his cigarette was a "simple act of forgetfulness . . . insufficient to break the chain of causation between the original injury and the burns sustained."[31]

The assertion that an inquiry into the claimant's negligence is not made to deny recovery for contributory negligence but to determine if the negligence is the legal cause of the injury provides a weak justification

Chevrolet Co., 222 N.C. 25, 27, 21 S.E.2d 834, 835 (1942). *See also* 5 J. STRONG, NORTH CAROLINA INDEX 2D *Master & Servant* § 55, at 399-400 (1968).

[26] Larson, *Range of Compensable Consequences in Workman's Compensation*, 21 HASTINGS L.J. 609, 610 (1970).

[27] Note, 19 U. CIN. L. REV., *supra* note 24, at 305.

[28] Hartley v. North Carolina Prison Dep't, 258 N.C. 287, 289, 128 S.E.2d 598, 600 (1962).

[29] Note, 38 CORNELL L.Q., *supra* note 17, at 101.

[30] 8 N.C. App. at 610, 175 S.E.2d at 346 (simple act of forgetfullness). *Accord*, Swanson v. Williams & Co., 278 App. Div. 477, —, 106 N.Y.S.2d 61, 66 (Sup. Ct. 1951) (carelessness or error in judgment); Anderson v. Industrial Ins. Comm'n, 116 Wash. 421, 423, 199 P. 747, 748 (1921) (imprudence). *See generally*, LARSON § 13.12, at 192.76. *But see* Note, 30 TENN. L. REV. 322, 324 (1963).

[31] 8 N.C. App. at 609-10, 175 S.E.2d at 346.

for insinuating negligence back into the formula for recovery. If the question as to whether the claimant's negligence was an intervening or only a contributing cause is a guide to recovery, why should the same inquiry not be made in regard to on-the-job injuries? The court, if it found the claimant's negligence an intervening cause, could report that it was denying recovery because the negligence and not the job caused the injury. However, as we have seen, even gross intervening negligence will not prevent recovery for one-the-job injuries.[32]

If the concept of proximate causation cannot be tested by inquiry into foreseeability or by the use of intervening causation,[33] it is useless in defining the situations where compensation for causally related subsequent injuries should be allowed.[34] Nevertheless, it could hardly be said that the act was intended to compensate the employee for every secondary injury suffered due to the interaction of the previous injury and subsequent conduct and events.[35] The North Carolina Workmen's Compensation Act relieves the employer from responsibility for the *original* injury if it was occasioned by the employee's intoxication or if he willfully inflicted the injury on himself.[36] Arguably then, some limitation should be placed on the employer's liability for a subsequent injury even where there is some causal relation to the prior injury. For example, if an employee became a quadruple amputee as a result of a prior compensable injury and later attempted to swim the English Channel, it would be ludicrous to hold the employer liable for his drowning death.

If neither the traditional "in the course of the employment" inquiry nor the concept of proximate cause is fitted to determining the range of compensable consequences of a prior, causally related compensable injury, how is the court to define those situations where such injuries will be

[32] *See, e.g.*, Hartley v. North Carolina Prison Dep't, 258 N.C. 287, 289, 128 S.E.2d 598, 600 (1962); Howell v. Standard Ice & Fuel Co., 226 N.C. 730, 732, 40 S.E.2d 197, 198 (1946).

[33] This is not to imply that foreseeability and intervening causation are preclusive tests of proximate cause. They are, however, the traditonal tests used to insert some certainty into the concept. Because most courts rely on these terms, they will be relied on here.

[34] The North Carolina Workmen's Compensation Act does not speak of proximate cause as a test of liability. Conjecturally, it might have been intentionally avoided. For that reason alone, the term should be avoided in workmen's compensation cases.

[35] "[B]ecause of convenience, of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point." Palsgraf v. Long Island R.R., 248 N.Y. 339, 352, 162 N.E. 99, 103 (1928) (Andrews, J., dissenting).

[36] N.C. GEN. STAT. § 97-12 (1965).

compensable? Professor Larson has been one of the few commentators to address himself to this problem.[37] His solution is to divide all employee conduct occurring subsequent to the first compensable injury into two categories: that necessarily and reasonably undertaken *because of* the prior injury[38] and that undertaken for other reasons.[39] The former category is delineated as "quasi [in the] course of [the] employment"[40] activity, the latter, non-"quasi [in the] course of." The range of compensable consequences for "quasi in the course of" activity extends to any subsequent injury not incurred as a result of the claimant's intentional conduct.[41] Thus, there would be recovery for injuries incurred during a trip to the doctor's office for treatment of a prior injury even if the claimant was negligent in some aspect of the trip. If the activity in which the claimant was engaged at the time of the second injury were not undertaken because of the prior injury, recovery would be denied by the Larson rule if there were any culpability greater than "mere" negligence.[42] Professor Larson's use of intentional and negligent conduct as determining the outer limits of the range of compensable consequences for a work-related injury still focuses the court's attention on intervening and thus proximate causation as a limitation on recovery. Such an analysis is subject to the same criticism as a proximate cause inquiry unrefined by "quasi course of" language.[43]

Most courts have recognized that industry should bear the burden for secondary injuries where the causal relation is sufficiently strong[44] and where the employee was not injured while engaged in activity highly dangerous for one in his condition.[45] Compensation for second injuries is denied where there is no proof of any causal relation or where claimant was reinjured while engaged in conduct highly unreasonable for one in his condition.[46] Denial of compensation in the first situation can best be

[37] *See* 1 LARSON §§ 13.00-.12.
[38] *Id.*
[39] *Id.* § 13.11, at 192.70-71.
[40] *Id.* at 192.68.
[41] *Id.*
[42] Professor Larson relates that it takes something more than mere carelessness on the part of the employee to relieve the employer of liability even though the employee is outside the "quasi-course" of the employment. *Id.* at 192.70-.71.
[43] *See* pp. 587-88 *supra.*
[44] *Cf.* 1 LARSON § 13.11, at 192.67.
[45] Adkins v. Rives Plating Corp., 338 Mich. 265, 272, 61 N.W.2d 117, 120 (1953); Jones v. Huey, 210 Tenn. 162, 167, 357 S.W.2d 47, 49 (1962); McDougle v. Department of Labor & Indus., 64 Wash. 2d 640, 644, 393 P.2d 631, 635 (1964).
[46] *See* authorities cited note 45 *supra.*

explained in terms of lack of sufficient causal relation to hold that the injury arose out of the employment. The courts usually deny liability in the latter situation after a determination that the activity in which the claimant was engaged when injured was not a normal one for a person in his condition. In proximate cause terms the activity would be called intervening negligence, and compensation would therefore be denied. However, instead of couching the inquiry in terms of proximate causation, less confusion and more consistent results[47] would be achieved if the limitation were versed in the very terms by which it is reached, *i.e.*, was the activity a normal one for a person placed in plaintiff's physical and mental condition by the prior compensable injury.[48] This inquiry may seem a return to the concept of foreseeability, condemned in workmen's compensation law;[49] however, it does not require that the claimants's second injury be foreseen by either him or the employer. Thus to be compensable, the injury must occur during participation in activities that, viewed in retrospect, are normal and expected and there must be some causal relation between the two injuries.

The suggested method of limiting recovery would eliminate the confusion[50] resulting from an analysis based on proximate cause although the end result in terms of liability may be the same. Proximate cause is essentially a policy determination as to whether legal responsibility

[47] The differences as to what the term "proximate cause" means to different courts is shown by the wide divergence in results on similar fact situations in workmen's compensation cases. *Compare* Wallace v. Judd Brown Constr. Co., 269 Minn. 455, 131 N.W.2d 540 (1964), *with* Prentice v. Weeks, 239 App. Div. 227, 267 N.Y.S. 849 (Sup. Ct.), *aff'd*, 264 N.Y. 507, 191 N.E. 538 (1933); Adkins v. Rives Plating Corp., 338 Mich. 265, 61 N.W.2d 117 (1953), *with* Colvin v. Emmons & Whitehead, 216 App. Div. 577, 215 N.Y.S. 562 (Sup. Ct. 1926); Fischer v. R. Hoe & Co., 224 App. Div. 335, 230 N.Y.S. 755 (Sup. Ct. 1928), *with* Whiting-Mead Commercial Co. v. Industrial Acc. Comm'n, 178 Cal. 505, 173 P. 1105 (1918).

[48] This test is closely akin to the "direct and natural result" of a prior compensable injury formulation announced in *Starr*. It is superior, however, because it diverts the court from all mention of proximate cause.

[49] *See* pp. 586-87 *supra*.

[50] The confusion caused the court by use of the concept of proximate causation as a limitation on recovery, even when the test is couched in terms of "quasi-course" of the employment, can be seen in *Starr*. There, the court cited Larson's treatise for the proposition that a claimant is allowed recovery for all consequences of his prior injury unless they occurred as a result of his intentional conduct. 8 N.C. App. at 611, 175 S.E.2d at 347. Accordingly, Starr's smoking in bed was held not to be an intervening cause of the burns. Professor Larson, however, would require that the claimant's smoking in bed be an activity *reasonably* and necessarily undertaken because of the prior compensable injury or anything greater than the claimant's mere negligence would bar recovery. 1 Larsen § 13.12, at 192.76. The court, however, made no finding that Starr's smoking in bed was reasonable or necessary.

should be imposed on one person for injuries incurred by another.[51] Rather than making this policy determination by using proximate cause with its myriad of meanings[52] and connotation of fault,[53] the court should ascertain whether the injury had sufficient causal relation to the prior injury and subsequently occurred in the course of activities normally expected to be undertaken by one in the claimant's condition.[54] Thus, in *Starr*, it might be said that smoking in bed was a normal activity for a paraplegic. Furthermore it is to be expected that an injured employee will engage in a certain amount of careless or even negligent activity. It is only when he embarks on a course of conduct that is highly unreasonable for one in his condition that he departs from the course of normal activities.

Even though, arguably, *Starr* was correctly decided,[55] the court should not use a highly technical and amorphous term such as proximate cause to determine the range of compensable consequences in workmen's compensation cases. If the use of proximate cause is not abandoned, the doctrines of tort law and workmen's compensation law will eventually fuse even though the avoidance of the common law concepts was one of the main justifications for the original passage of the workmen's compensation acts.[56]

C. H. POPE, JR.

[51] *Cf.* W. PROSSER, LAW OF TORTS § 49, at 282 (3d ed. 1964).
[52] *See* note 47 *supra.*
[53] *See* note 26 *supra.*
[54] "Normal and expected" are used here not as a suggestion that foreseeability is required but in the sense that in retrospect the claimant's conduct is not surprising.
[55] Whether Starr's recovery should have been allowed hinges on whether smoking in bed was a normal and expected activity for a person subject to having muscle spasms. A paraplegic could not be expected to get out of bed every time he smoked a cigarette.
[56] Conrad v. Cook-Lewis Foundry Co., 198 N.C. 723, 726, 153 S.E. 266, 268 (1930).